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PROPOSED CHANGES IN FARMERS HOME ADMINISTRATION CREDIT REGULATIONS

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

MARCH 11, 1987

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PROPOSED CHANGES IN FARMERS HOME ADMINISTRATION CREDIT REGULATIONS

WEDNESDAY, MARCH 11, 1987

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9:07 a.m., in room 332, Russell Senate Office Building, Hon. Patrick J. Leahy (chairman of the committee) presiding.

Present or submitting a statement: Senators Leahy, Melcher, Boren, Harkin, Conrad, Fowler, Daschle, Lugar, Helms, Cochran, and Wilson.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. The Senate Committee on Agriculture, Nutrition, and Forestry will come to order. Last month this committee held hearings in five Midwestern States. We heard a lot of different things, from the problems of rural development to the problems of feed prices going down, and a lot of other things in between. There was one thing we heard, though, every place we went. At every single stop we were confronted with loud complaints about the regulations that are the subject of today's hearings. We were told that the regulations would have a disastrous effect on farmers.

I promised the farmers at each one of these stops that the committee would take a fast and hard look at these regulations. In fact, the first thing I did when I came back from those hearings was to call Secretary Lyng to make sure that the comment period on the regulations would be extended. A number of people told me they had received the very complicated and extensive regulations with only 2 to 3 weeks left to comment on them, and there is no conceivable way that they could decipher them and comment on them in that amount of time.

I appreciate the fact that the Secretary did extend the comment period by 30 days. We scheduled this hearing to get the facts while the comment period was still on, because I may well want to comment myself.

I've looked at the proposed regulations. What I've seen really disturbs me. The regulations are a dramatic shift away from the agency's mandate to provide supervised credit to farmers in trouble who are not being properly serviced by commercial institutions. I've always heard that the Farmers Home Administration is supposed

to be the lender of last resort. It seems to me that by these regulations we are trying to make them a big, impersonal city bank, with regulations that would be similar to a commercial bank. If that is the case, then we really don't need Farmers Home at all. If they are not going to be any different than a regular bank, then we don't need them. But if they are to be what the Congress has said and what the people expect them to be, the lender of last resort, then I question the efficacy of these regulations.

The Farmers Home Administration has always been a bulwark in our defense against farm bankruptcy and foreclosure, and it is going to be the duty of this committee to make sure it stays that way. I am particularly disturbed that the agency would propose regulations of such magnitude without adequate prior consultation with Congress or farmers, and then would unreasonably limit the time for public comment. Thirty days is not enough time for anything this complicated. You could run the proposed regulations through a major Wall Street law firm, and they would have a difficult time coming back in 30 days with adequate comment on them. Certainly, farmers that are putting in long days, hours, weeks, and then in such a short time on something this complicated asked to comment—it's a joke to even expect they could.

I think some of the proposals before us today run counter to the law. Maybe that would go unnoticed if the 30-day comment period remained; with a 60-day period I hope it doesn't go unnoticed. I don't think this committee can sit by while the agency disregards the policy set by Congress. It is clearly embodied in the legislation that defines the agency's mission. For example, the proposed restrictions on the use of Farmers Home credit to provide cash rent on the availability of emergency loans aren't consistent with current legislation. Other proposals are simply bad policy—I don't find them acceptable. The new eligibility test proposed by the agency would remove large numbers of farmers from the borrower rolls who deserve to be on those rolls. These farmers are in trouble; Farmers Home was created to help them—it's as simple as that.

I am not opposed to the creation of a mechanism to define eligibility, but I am, however, opposed to the results of the mechanism proposed by these regulations. Farmers Home was formed to carry out a function not being served by commercial institutions.

I think the proposed regulations change that equation dramatically, certainly contrary to past history, certainly contrary to past practice, and, in my estimation, contrary to the law.

But when I called the Secretary and later wrote him, asking for an extension, he wrote back and listed only five specific ways in which this 98-page proposal would benefit farmers. He talked about cross-collateralization and conservation easements—that's 4 of the 98 pages. The cross-collateralization doesn't even seem to be in there, at least I couldn't find it. Loan consolidation, reduced rates of interest, which is clearly beneficial to Farmers Home borrowers, that could have been allowed in a very short regulation; you don't need a 98-page rule for it. Other things seemed to be simply redundant. I read the Secretary's letter and what he tells me could have been done in about 2 pages, not in 98 pages of obfuscation.

While I realize that when lawyers and other people get involved, the situation becomes more complicated and the process length-

ened, I would remind the Department of Agriculture that the Lord's Prayer has 56 words, the Twenty-Third Psalm has 118 words, the Ten Commandments have 297 words, and this regulation which nobody can understand has 90,000 words. For whatever it's worth—I'm not suggesting that you are to do the Lord's work, but I'm sure this work could be completed in a heck of a lot fewer words.

I have some other concerns with these regulations. I know Mr. Clark is only going to be with us a brief time this morning. I will therefore ask my colleagues to defer their opening statements.

Mr. Clark, we are delighted to have you here, and I'm sure you are delighted to be here. [Laughter.]

Go ahead, sir.

STATEMENT OF VANCE L. CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. CLARK. Thank you, Mr. Chairman and members of the committee. Good morning. I do appreciate this opportunity to be with you today, limited as our time might be, to discuss our operations at Farmers Home, and, more specifically, our efforts as a lender of last resort, as we specifically try to meet that lender-of-last-resort role, to improve the delivery of credit services to rural America, which includes some 275,000 farm borrowers, Mr. Senator. As you know, Farmers Home is the largest single source of credit for more than 1½ million families on our Nation's farms and in their neighboring communities. In some cases we have become the only major source, it seems. Our outstanding loan portfolio of about $70 billion is now larger than that of the Farm Credit System, larger than the World Bank, and is exceeded by only a handful of the largest banking institutions of the Nation. We have a mandate and a responsibility to see that we administer that portfolio in a compassionate yet judicious manner.

In the 51-year history of the Farmers Home, we have provided more than 9.8 million loans and grants totaling just under $141 billion. The largest share, about one-half, went to farmers; the remainder financed a wide variety of rural housing, community, and business projects. We closed out last year, the 1986 fiscal year, with almost 2 million outstanding loans in our $70-billion portfolio.

Mindful of the problems facing a large number of farmers today, we have concentrated our efforts not only on making loans, but, even more importantly, in working with our borrowers to make those loans successful. During the last fiscal year, special servicing assistance was extended to our 275,000 farm borrowers in almost 100,000 instances. This included 43,000 loans rescheduled or reamortized, 2,500 loans deferred, 25,000 subordinations to other lenders that would allow new credit to be extended by the private sector, and 28,000 loans refinanced at a more favorable limited resource rate, offered currently at 4.5 percent for operating loans and 5 percent for farm real estate loans.

On a dollar basis, 73 cents of every dollar loaned in our direct operating and ownership programs were at that limited resource rate. This special servicing took in about one in every three of our farm borrowers. As it was, we were able to keep over 98 percent—

98 percent—of our farm borrowers in business for 1986, or, to put it another way, only 1.9 percent of our farm borrowers left our rolls last year.

In addition to helping farmers survive, this aggressive activity also has had a role in building that $70-billion portfolio. The continuing increase in debt owed to the Government has become cause for great concern, and rightfully so, especially since a growing amount of it may be uncollectible.

As of the end of the 1986 fiscal year, $4.8 billion of the $29.6-billion farm operating loan portfolio was more than 3 years in arrears. We expect that much of that overdue debt will eventually be written off the books. Nevertheless, many good farmers are still making headway in these days of general economic stress, and we want to continue to help them survive in agriculture.

One important way to do this is to streamline and improve our delivery of credit and loan servicing. A major effort to improve this service is represented in those proposed regulations published in the Federal Register on January 15 as "General Revision of the Farmer Program Regulations."

As you've said, Mr. Chairman, you expressed an interest in the timetable originally established for those regs and the period for public comment on the proposals was extended to March 19. We are receiving comments, and we will examine and consider every one of those comments. Because the period is still open, I cannot say today when we would expect to have a final version ready for publication.

The CHAIRMAN. I wonder if I just might interrupt on that. At the end of those 30 days, what will you do? Will you just issue regulations, or will you go back out and begin the normal procedure again?

Mr. CLARK. The proposal is to issue those in final form, Mr. Chairman, but we will be happy to share them with you and this committee before publication, if you desire.

The CHAIRMAN. I think that would be a very good idea. Go ahead.

Mr. CLARK. In general, those new regulations are intended to improve our ability to service loans once they are approved, provide better guidance to our borrowers on the information they need in dealing with our field offices, and make it easier for commercial lenders to make and service loans with our Farmers Home guarantees.

Some of the comments received so far suggest that additional work may be required to achieve that goal, and, naturally, as I said, we will consider every one of those suggestions. Based on early comments, individual proposals we expect to revisit include, and certainly are not limited to:

(1) The preapplication screening ratios. There's been a lot of concern in that direction. The concept of FmHA ratios would be the same as that of other commercial lenders, to assure that creditworthy borrowers are able to get loans. Our hope was to reduce that loan processing time, which now averages, last year, some 56 days for our direct loans.

(2) We are also looking at whether or not to include nonfarm income in the ratio factors. Our original thought was to wait until

that application stage was reached to include that income, but we are still open in that direction.

Rather than attempt a point-by-point recitation of those proposals, Mr. Chairman, I will end my statement at this point and be available to you to answer any questions you or other members of the committee might have. But before I do that I would like to briefly mention another subject that has been widely misunderstood, and I think misinterpreted, from some of the press accounts I've seen. That subject is our handling of farm property that has come into our hands through various means.

As you will recall, we had a strict policy for about 3 years that no farm property would be sold if the sale would adversely affect surrounding property values. Our State directors were under firm instructions in seven States to sell no property without national office permission. The other States were to carefully consider the local property value question, and only if the answer came out that no local values would be harmed would they proceed with that sale.

That decision was made when farmland values were falling, and falling rather precipitously in some States. For the most part, however, we hope that slide is ended. However, we find ourselves with some 5,000 farm properties on our hands that we cannot properly or economically manage.

A few weeks ago I instructed our State directors to begin taking steps to put that property on the market. But—and this is crucial—I reminded them that the injunction concerning local property values still stands, as it is now mandated by the 1985 Food Security Act, and they were required, required without exception, to offer the former owner or operator that first option to lease or buy that farm back.

With those important caveats, we plan to sell inventory property, but in an orderly, systematic way. We are not in the business of running farms, and, I hope you agree with me, we should not be. Most of the accounts I saw on the subject, however, missed those points entirely and talked instead about Farmers Home "flooding" the local markets or planning to sell huge blocks of land. That simply is not the case, and I appreciate the opportunity this morning to clear up any confusion on that subject that might have come your way or to the attention of other members of the committee.

I would be happy, Mr. Chairman, to respond now to any questions you might have.

The CHAIRMAN. Thank you, Mr. Clark. I have a couple of questions, and I would propose that we go around in order so that the various members have an opportunity to ask questions. At these hearings we had, you would almost have to be there to understand the depth of the feeling on these regulations. In fact, I would strongly suggest that if we have further hearings in these areas, you or a designee from your office may well want to come out to a couple of the hearings. I intend to ask different members of this committee on both sides of the aisle to do some follow-up, either with hearings or meetings in some of these parts of the country as we go along just to make sure that what we are hearing there is what we are hearing here in Washington. My concern has always been that in Washington, while we have some excellent people to

testify, we sometimes get a different perspective than we do out in the field. And so when we have some of these follow-ups, I would invite you or somebody you may want to designate from your office to come to them, because there is very great concern.

Obviously we can joke a little bit about the detail that's in these proposed regulations, but a great deal of time and effort went into the development of these regulations. Why wasn't there any attempt to get any kind of congressional input?

Mr. CLARK. Well, I must say I think we were out there digging and asking for input. We had some other things in that package that we did remove. One of them was the "family farm" definition. We thought that should be in there. I got no support from Members on the Hill, including the House Ag Committee; we finally gave up, there was no support for a definitive determination of "family farm" definition. So I think we have tried.

The CHAIRMAN. Who did you consult with?

Mr. CLARK. I consulted with Chairman "Kika" de la Garza and members of his staff on that particular issue.

The CHAIRMAN. Who did you consult with overall, or did you do most of the regulations in house?

Mr. CLARK. By their very nature, it's difficult to go out on the street corner to solicit inputs on these things. Your staff—it seems like every Hill staff—is terribly overburdened already, and we don't get too much response when we come up with suggestions. I would be happy to——

The CHAIRMAN. Did you go out and talk with farmers or farm organizations in some of the parts of the country that would be most affected by these regulations?

Mr. CLARK. I think we did; I think we had input from a lot of organizations. Incidentally, I have been to the field, Mr. Chairman, many times in the last 20 months, listening to farmers, listening to activist groups, listening to anybody who will tell me what's wrong with what they see about our delivery system for credit. We do seek input.

The CHAIRMAN. Well, do you see some major changes in these regulations?

Mr. CLARK. Yes, I do—in their final form, I do. And, as my testimony stated, we want to look at some of those issues. The off-farm income is an important issue that should be considered as we prescreen applicants.

The CHAIRMAN. But if these are major changes, as they appear to be, why only a 30-day-comment period on something that is this significant?

Mr. CLARK. Well, I'll tell you, my personal goal was to have those issued last June so we would be well ahead of the crop season. Our enthusiasm to get those in the field and to get them in place for this crop season pushed us, I think, to a lower threshold of 30 days. We have problems with general counsel as we try to put regulations out. Incidentally, if the bureaucracy tried to write the Ten Commandments, they would come out with at least Fifty. It's impossible sometimes to push—it's like pushing a string to get regulations out. It's a long and involved process that is very frustrating.

The CHAIRMAN. I understand that, but when you send out something this complicated with only 30 days, don't you give the impres-

sion to farmers throughout the country you've got to take it or leave it, this is what you're going to get, and the comment period is merely window dressing—there are the regulations and you're not going to get any changes? We are not really asking for your comments, we are telling you what we are going to do. Doesn't it really say that?

Mr. CLARK. Well, I can see your perception of that and, I guess, if I was sitting at the other end, I would probably perceive that, too. But it is not our intention to ram those down anybody's throat.

But I agree, that could be perceived in that manner.

The CHAIRMAN. Well, you speak of that as being a perception, but isn't that the reality? I mean, you have a training manual, a lot of work put into this training manual, and a lot of training programs were already set up. These regs have been written out, put together, printed, and it's based on the assumption that they are going to go through precisely the way you proposed them, and that no matter what the comment period might be, these are going to be the regulations. Doesn't the training manual itself say that you made up your mind, you got it—like it or not? Doesn't that say that to you? Or are we printing training manuals for the sake of printing training manuals?

Mr. CLARK. I hope that doesn't say "training manual," does it? Because we were——

The CHAIRMAN. Training module. "Module Work Book—Farmers Programs Changes." All printed up. You've got all these procedures about how to do it. I understand that people are already being brought in and are being trained based on regulations that have not been formerly put into effect. Doesn't this really give the impression that we don't give a darn about the comment period? Here they are and away we go.

Mr. CLARK. Again, I hope that's a misperception, but that is not a training manual. I'll have to look up the word "module" now that you've brought it up—I'm not sure I know what that means.

The CHAIRMAN. Training module, training manual—do's and don'ts in liquidation—it says "How to take this course," and you read this before starting the tape—there's even a tape with it. "This is a self-instructional audiocassette training module about recent changes to Farmers Home Administration Farmer Program Regulations, and the goal is to acquaint you with the recent changes in the Farmers Home Administration Farm Program Regulations and how to implement the new Regulations in your office." It assumes they've gone through; there's no question about it. It makes the idea of a comment period merely window dressing.

You know, the last thing it says is enjoy—"Now get comfortable and be sure the tape player controls are handy—you'll be stopping the tape frequently—and starting the tape." With these regulations I'll bet they are starting the tape—they're starting and stopping and starting and stopping. The idea of saying they are going to be comfortable may be a bid of a facade. But this manual says it's done, it's over, right?

Now, I'm just a smalltown lawyer and maybe you guys here in the big city know it better—you probably heard that line before.

Mr. CLARK. I'm not from the big city either, Mr. Chairman. We tried to get the jump, if you will, on this immense problem. These,

as you say, are complicated regulations. That program was designed for what we call our district directors, some 200. If indeed the regulations go through, we wanted them to have a leg up on what that was all about, so they indeed could start the next step of training our county supervisors out there. That is not cast in stone, cast in iron.

Incidentally, we opened our meetings up for comments. We got 400 comments from those who sat through those—not training sessions, but informational meetings, to tell us what they saw in those regulations; 400 comments—and we are going to consider every one of those 400.

Incidentally, I wish we had erased the tape—but that's the way it goes. [Laughter.]

The CHAIRMAN. That's been an attitude of those before you, Mr. Clark, I assure you. For a moment there I thought I was back at another committee I used to serve on.

The Senator from Montana.

Senator MELCHER. Mr. Clark, prior to your current position, I assume you worked with small lenders.

Mr. CLARK. I did.

Senator MELCHER. Where?

Mr. CLARK. I was in California with the Bank of America, the largest agricultural bank in the Nation at that time. We had many, many small branches in that system; I had the responsibility for about 105 branches, most of them small lending arms. Those lending officers were charged with dealing with small farmers and large farmers.

Senator MELCHER. You have 275,000 farm borrowers and 2 million outstanding loans. How did that happen?

Mr. CLARK. How did that happen?

Senator MELCHER. Yes. The ratio indicates that there's about seven and some fraction loans to every farm borrower. How did that happen?

Mr. CLARK. You are probably looking, Senator, at our total portfolio—that's our total borrowers, including housing, our community facility loans, everything; that's our total borrowers.

Senator MELCHER. You are mixing apples with oranges. You've got 275,000 farm borrowers. How many of those outstanding loans are to farmers?

Mr. CLARK. There is a multiplicity in borrowing: a farmer can have more than one loan with us. I'm reminded it's 2.6 loans per farmer in our portfolio. So he has more than one loan.

Senator MELCHER. Yet you say 40,000 of those roughly 600,000 or 700,000 farm loans have been amortized, or rescheduled, or restructured. What's holding you up?

Mr. CLARK. Holding us up?

Senator MELCHER. Yes.

Mr. CLARK. I'm sorry, I don't understand your question, Senator. Holding us up in what way?

Senator MELCHER. Isn't 40,000 a rather small amount for rescheduling or restructuring?

Mr. CLARK. Again, cash-flow has to enter into this. Even if we restructure, even if we reamortize and stretch that loan out, if it doesn't——

Senator MELCHER. I take it you never had experience with chapter 12, because that's new, isn't it?

Mr. CLARK. No one has had experience with chapter 12, and that's a big cloud hanging over every lender out there.

Senator MELCHER. Do you know what it's for?

Mr. CLARK. I read the reasons for it, yes.

Senator MELCHER. What do you think the reasons for it are, then, that you've read?

Mr. CLARK. To go another step, to go another mile, to allow another chance for that farmer to survive.

Senator MELCHER. Like rescheduling, restructuring, and reamortizing.

Mr. CLARK. Forgiving.

Senator MELCHER. Well, you had 2,500 loans that you just canceled out. You have 600,000 or 700,000 loans; you have a portfolio of $70 billion; and assume that half of that is farm loans.

Mr. CLARK. $29.6 billion.

Senator MELCHER. $30 billion in farm loans, and you've only managed to reschedule 40,000 loans. Don't you think chapter 12 is going to force you into that position?

Mr. CLARK. Senator, the terrible delinquency that we have in our emergency disaster loans, economic emergency loans is over $5.8 billion. There's no way those can be salvaged. Many of them are 7 years old; no rescheduling will ever——

Senator MELCHER. Don't you think chapter 12 is to force you into rescheduling and reamortizing?

Mr. CLARK. It could, as it will force—but I'll tell you, I'll bet——

Senator MELCHER. You people came here and told us a year ago that you needed more authority to farm it out to the bank.

Mr. CLARK. Well, it's our guarantee program; we have operation assist, subordination.

Senator MELCHER. Twenty-five thousand have been subordinated.

Mr. CLARK. Yes.

Senator MELCHER. So it hasn't been such a hot program, has it? Why hasn't it?

Mr. CLARK. Well, if you look at our numbers, it is a hot program.

Senator MELCHER. Twenty-five thousand?

Mr. CLARK. I'm talking about today's guarantee program. It is really building—it's twice as much as it was a year ago.

Senator MELCHER. Well, what is it, then? You just testified 25,000. Am I reading you wrong?

Mr. CLARK. That's rescheduling you're talking about?

Senator MELCHER. It says "subordinated."

Mr. CLARK. Yes, we could have—there are many of our borrowers who have joint debts: they have debts with us and they have debts with other lenders.

Senator MELCHER. Well, how many loan guarantees, do you have out?

Mr. CLARK. We have guaranteed so far this fiscal year about 3,770 guaranteed operating loans; and in our farm ownership loans another 870. In fiscal year 1986 obligated guaranteed farm loans totaling $1.6 billion—that's the highest we've ever had—in 1985 we obligated $1.2 billion, and $143 million in 1984, and only $70 million in 1983.

Senator MELCHER. Let's just talk about loan numbers. How many have you either subordinated or had guaranteed by a bank?

Mr. CLARK. I'm sorry, Senator, I can't pick that out of the hat; I'd be happy to furnish that in detail for the number of years you would like.

Senator MELCHER. Well, Mr. Clark, you asked this committee to broaden your authority for loan guarantees. We very willingly did that and gave you that authority. And you can't tell us what you've done with that?

Mr. CLARK. Yes, we can. If you wait a moment, I'd be happy to dig it out for you.

Senator MELCHER. I'll get to that on the next round. What I'm getting at is you have 600,000 or more loans, most of which are in trouble. But you've only had 40-some thousand rescheduled. That is a very small number. You've got some out under loan guarantees. I assume every one of those loan guarantees has to be subordinated, doesn't it?

Mr. CLARK. No, it does not.

Senator MELCHER. I have another concern. I often ask the Secretary: Do you have enough personnel, are they good enough quality, do you need some more help that way? The answer he gives is that he isn't aware that you do. What's the reason for all this? You've got a backlog that's got everybody backed up, and you can't handle it in some of these offices, and some of the personnel you have there obviously aren't qualified to look at these bad loans.

Mr. CLARK. It's a pretty broad brush you're using, Senator; we have a lot of dedicated hard-working people out there, well-trained—in fact, our greatest loss of people is to other banks in the Farm Credit System who want our officers. So, I think that speaks well for the quality of staff we do have. I think that's a little unfair.

Senator MELCHER. Now, Mr. Clark, that seems pretty odd to me when almost all commercial bankers are trying to get rid of agricultural loans. Where is this happening? Who's after them?.

Mr. CLARK. Small independent banks in ag communities are after our people, and so is the Farm Credit System, so is the Farm Credit Administration—they are looking for good, dedicated, hard-working agricultural lenders, and they are coming to us. In fact, our turnover is too high; I wish we could stop it.

Senator MELCHER. Are you telling me, then, that you don't have qualified personnel out there, that you are losing them?

Mr. CLARK. I'm telling you we are losing a lot of good people, but we are training—we have an intensive training program that I think is paying off. That tape is part of what we are doing, the workbook and a tape.

Senator MELCHER. Have you enough personnel?

Mr. CLARK. We've never had enough personnel. We run about 2,000 short in our agency, our plate is running over. The housing program distracts us, I think, from the farm programs that we do. We try to run a balanced program.

Senator MELCHER. Mr. Clark, I'll get back to you in our next round of questions about those figures on how many loans out——

Mr. CLARK. We have 24,452 guaranteed loans out there for our farm operating loans.

Senator MELCHER. Twenty-four thousand?

Mr. CLARK. Yes.

The CHAIRMAN. Mr. Clark, one of the places where I first really started hearing about the problems with these Farmers Home regulations was in North Dakota—and I heard it loud and clear. Senator Conrad arranged to get a number of people from the attorney general's office and others over to meet with me, and with the Governor. Senator Conrad had said that the problem was even greater than I might have thought; if anything he understated the reaction I was getting, and I appreciate the fact that he brought it to my attention.

I yield now to the Senator from North Dakota.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you, Mr. Chairman.[1] I want to publicly thank the chairman for holding these hearings, because I think we clearly have touched a nerve, certainly in my State and the rest of the Midwest where we traveled during the break. Rarely, as someone in public life, have I ever heard such an outcry as I have heard relating to your agency. I have here the comments on the regulations that come from the attorneys general of four States—the attorneys general for Iowa, Illinois, Minnesota, and North Dakota. And, frankly, it's a devastating commentary on the proposed regulations.

I don't know if you've had a chance to see this. You will be receiving it today, if you haven't already.

But rarely in my experience in public life have I read a document that is as devastating a commentary on the work of an agency of government as is this one. Let me just read from some of this. "We strongly object to many features of these proposed regulations. If adopted, these regulations would have a devastating effect on the farm economies of our respective States." They say specifically "We believe use of these ratios . . ."—they are talking about the preapplication and application risk ratios—"would disqualify about 50 percent of FmHA's existing borrowers from even being able to apply for credit from FmHA."

My first question would be: Do you have any analysis of how the ratios would affect your loan portfolio and the eligibility of borrowers who are currently FmHA borrowers and also potential new borrowers? Has any analysis been done?

Mr. CLARK. Yes, we have. We did an analysis on our existing portfolio. If we put into effect those ratios today, how many borrowers that we have on our books today would not be there? About 18 percent kicked out.

Senator CONRAD. Could we have copies of those internal studies that have been done?

Mr. CLARK. Be happy to furnish those to you.

[The information requested by the committee follows:]

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[1] See p. 89 for the prepared statement of Senator Conrad.

Based on three preliminary studies it appears that the Pre-application Risk Index (PRI) and Final Risk Index (FRI) will prevent approximately 18-20 percent of existing FmHA borrowers from qualifying for future assistance.

The first study was conducted using data from 80 borrower files from various states. In this study the PRI and FRI were calculated for each borrower. This study concluded that the PRI or FRI would have caused 10 of the 80 borrowers or 12.5 percent to be rejected for further assistance. The second study was conducted on 36 borrower files from the Olney, Illinois FmHA County Office. This study concluded that six loans would have been rejected by the PRI. These six loans rejected out of 36 tested equates to 16.6 percent of the loans that would be rejected for further assistance based on the ratios.

The third study was conducted on the 19,504 existing borrowers in the FmHA FARMS Data base. This showed that 5,252 of the borrowers in FARMS do not have positive cashflow and would be rejected for further assistance based on the existing regulations, and the PRI or FRI has no bearing on these borrowers. Therefore, from a base of 14,252 existing borrowers, the FRI was calculated for each borrower. Results showed that 3,284, or 23 percent, of the 14,252 borrowers had a FRI of nine or more and would be denied further assistance. Based on these three preliminary studies we have estimated that approximately 18-20 percent of the existing FmHA borrowers would be affected by the PRI and FRI.

NAME	CURRENT ASSETS	CURRENT DEBTS	TOTAL ASSETS	MARKET TOTAL ASSETS	TOTAL DEBT	NET WORTH COST	Change of Net Worth Cost	N.W. CHANGE BY VALUE	NET WITHDRAW	CROP SALES	LIVESTOCK SALES	BREEDING ST.SALES
Average	73436.22	62930.17	235475.17	308064.31	246737.92	-11370.00	7778.81	-4975.19	19761.50	72736.53	23190.31	1109.36
*	202118	128219	449476	556518	538458	-90072	57228	74194	24000	272370	0	0
*	182528	140727	856782	1218028	827327	29455	71392	120269	21269	96300	16978	0
	164903	68789	403951	415878	373158	30793	52287	20756	14196	24309	243411	13943
	6302	19953	102032	361402	234181	-132149	44060	-201793	16673	52566	0	0
	229356	188579	520313	567268	531764	-11450	33512	-27032	23791	270603	0	0
	83787	15041	240924	256437	193331	42593	13034	21216	21766	64558	40170	4798
	117064	75300	351542	530723	343178	9636	6374	-3818	38919	90512	23297	1906
	72822	8825	283942	224697	202363	81579	40164	-76599	3570	53744	0	0
	66065	50262	227249	401209	314799	-87550	-7058	19326	49878	102994	2116	0
	82151	32976	189206	349952	153218	35998	7672	-15373	29861	89875	7201	0
	27076	6407	85918	98926	34663	51255	13091	8380	21971	0	45061	12669
	72688	62605	312999	517775	375379	-62380	21310	-14363	11285	41783	64762	618
	16525	20372	246335	210575	252855	-6520	-42280	5799	12260	51192	1204	280
	25443	35529	60126	58940	43353	16773	11970	10218	17850	34464	106987	0
	63061	46333	175576	203201	147453	28123	27293	43870	10297	35765	46305	1872
	57376	66037	173978	210501	186010	-12032	11526	5297	18253	74778	2435	0
	84142	64980	221770	341657	193613	28157	742	7169	28031	93722	0	0
	15309	28775	164813	244101	187252	-22439	8490	395	17063	12975	0	0
	93045	86693	314147	373145	277283	36864	2098	11990	23015	90051	0	0
	43490	19546	94874	133446	98717	-3843	18269	1033	7091	23144	47995	0
	109092	102304	302887	406217	508491	-205604	24320	-181919	12300	88126	0	0
	68567	87531	200616	359433	289655	-87039	-31392	-7330	25668	114418	0	0
	32500	29310	146838	134900	124352	22486	7704	-35637	15614	30762	24858	315
	14225	10731	152847	102377	108370	44477	4743	-2720	16673	8484	6957	195
	37674	26284	124313	137074	80610	43703	14878	-5130	5760	24879	0	
	16625	57862	56035	106550	104977	-48942	-7388	2626	26431	21088	23558	
	64000	74250	161112	427775	144149	16963	-16464	29021	35098	73565	0	
	53987	51888	284357	381387	288177	-3802	6997	-4671	11164	47773	0	
	2499	6943	42499	51399	38711	3728	551	45	17446	4815	0	
	128690	150632	226017	169690	191132	34885	5120	-24354	8840	124072	0	
	58063	98897	294866	231088	254146	-59280	2253	34658	9948	95345	0	
	82977	91592	255452	210070	225604	25848	-7713	2560	14614	66034	41768	
	158962	147428	256010	287962	269911	-13901	-49961	-17077	53771	137891	107987	
	78588	54994	215523	421840	197706	17817	-25373	24830	23447	131686	0	
	24732	62102	250523	343292	299744	-49226	-21240	809	15347	54084	2451	-101
	7272	46790	32258	39872	148475	-116217	-18082	-10752	7454	19788	-362	240

* Names not available because of Privacy Act restrictions.

7100.94	12586.11	-145.25	3078.50	2107.28	115549.13	4564.03	9826.89	107905.64	63433.81	57837.67	15348.64
MILK SALES	GOVERMENT PAYMENTS	HEDGING INCOME	OTHER	ADJUSTMENTS IN INV.	GROSS REVENUE	LESS LIVESTOCK PURCHASES	LESS FEED PURCHASES	VALUE OF FARM PRODUCTION	CASH OPERATING EXPENSE	OPERATING ADJUSTED	DEPREC.
0	10140	0	1015	30783	322588	0	0	322588	175480	170030	50837
255480	41490	0	21629	0	397631	2600	43258	351773	235400	208440	35999
0	10294	-2727	3156	2539	294925	9691	97090	188144	76965	72207	27552
0	9115	0	0	2133	63813	0	0	63813	38269	37595	11440
0	32722	2053	6702	0	312080	0	0	312080	174989	216343	31240
0	14526	0	0	5000	0	0	13318	115734	64165	63720	5413
0	12797	0	9254	4064	141030	1265	4975	135590	82234	64333	20315
0	44023	0	0	0	97767	0	0	97767	61352	45381	7200
0	3586	0	0	0	110598	0	228	110370	43591	31619	11326
0	13614	0	20	232	77526	0	332	77194	51733	45115	9357
0	0	0	0	-650	68586	2550	30592	35444	10695	9219	8900
0	8685	0	0	0	95848	0	19102	76746	35015	30475	4972
0	5119	-601	9879	1650	68523	385	315	67826	31109	30355	12329
0	3598	0	0	0	141451	39256	24425	77770	36393	36998	7835
0	6746	0	0	1795	74257	2250	16157	55850	17700	19700	9670
0	9079	0	0	4000	0	319	696	89277	49797	47775	4488
0	20140	-2765	5926	12474	129497	0	0	129497	83341	-2557	-2015
0	4534	0	0	-9860	35397	0	0	35397	15023	15258	618
0	17888	0	1047	10783	119789	0	0	119789	78062	60351	17711
0	4040	0	1426	2594	101125	2668	17000	76115	39391	37597	14122
0	15834	0	14485	-950	127151	0	0	127151	66184	57149	27705
0	15614	0	12970	0	143007	0	0	143007	79318	81325	56685
0	8970	0	0	0	67740	5146	3698	58896	30050	28300	9679
165	1399	0	0	0	18955	1350	1961	15644	8364	8370	9431
0	4374	0	0	1600	28794	0	0	26794	50907	20154	1245
0	5031	0	0	-2000	44605	4025	6833	33887	22601	13476	15924
0	14315	0	209	0	88089	0	0	88089	46147	46197	16006
0	23475	0	3640	8055	82943	0	0	82943	47696	47412	11130
0	807	0	0	1260	6882	0	0	6822	5573	5334	1535
0	8749	0	0	0	132821	0	0	132821	100570	95040	4893
0	12429	0	0	-5000	118487	0	0	118487	73620	74975	5403
0	7842	-683	9103	0	162291	40268	22287	99636	84508	86146	6711
0	12887	0	3582	1545	263892	52172	21259	190461	126406	129486	46333
0	20248	-506	7763	6092	131686	0	0	131686	71809	75430	20398
0	14794	0	220	-2087	68452	0	823	67529	37906	39666	20859
0	6094	0	0	-150	22765	0	758	22006	31034	34742	1304

0139.47	13998.14	2070.03	19997.19	9017.69	888.83	29153.08	95822.58	81725.25	903.42	430.22	126.72
TOTAL ERATING EXPENSE	INTEREST EXPENSE	DISPOSAL OF FARM ASSETS	NET FARM INCOME	NON-FARM INCOME	Income Taxes	NET INCOME	BALANCE AVAILABLE	DEBT REPAYMENT	TOTAL ACRES FARMED	OPERATOR'S SHARE OF ACRES	ACRES OWNED
228867	30717	19024	82028	0	0	82028	260365	225425	3169	2018	81
244439	36003	0	71331	3206	0	74537	181471	174250	878	878	675
99768	21983	0	66393	0	0	66393	85497	40373	230	230	79
49034	12343	42000	44436	16297	0	60733	74002	49558	635	334	213
247583	22416	0	42081	14020	1631	54470	168356	141179	1312	1048	125
69133	12397	0	34204	19314	80	53438	83955	70429	583	428	40
84648	15051	2206	37297	12996	5000	45293	115198	112938	610	577	368
52581	11475	0	33711	6023	0	43734	37638	21818	636	318	44
42945	33014	0	34411	7630	0	42041	116454	107764	838	643	160
54472	7778	0	14944	22713	0	37658	91341	53095	450	323	209
18119	2328	0	17325	17737	0	35062	19207	3970	50	50	1
335447	25191	0	16108	20814	4327	32595	103558	97382	538	440	240
42684	11753	0	13206	13507	800	30113	67684	62800	152	134	100
44834	3116	0	29870	0	0	29820	166935	47528	101	59	1
35401	-4521	0	30997	1500	2800	29697	84718	43190	440	260	80
52263	8262	0	28779	0	0	28779	62460	58600	411	345	40
96503	7731	-763	24500	4589	316	28773	87065	74065	823	317	120
15876	14874	5	4647	22937	2031	25553	57515	50819	120	88	80
78062	17048	0	24659	3364	3000	25023	112424	99981	598	484	191
51719	4378	0	20018	5342	800	24560	77533	28937	188	146	1
86284	18456	0	22411	2183	0	24394	170038	157412	538	390	198
138010	25156	44392	24233	387	344	24276	81181	75488	809	555	40
37979	10449	0	10168	13000	1000	22468	59677	54677	568	414	100
17801	7954	0	-9211	30877	250	21416	26141	17784	82	65	55
21399	5240	0	155	23183	2700	20638	41628	36649	274	136	1
29400	10431	0	-5944	24987	0	19043	48131	66051	279	207	1
62203	5252	0	20634	0	2000	18634	39249	44236	406	328	310
58542	15240	0	9161	9000	0	18161	76719	64140	371	327	240
6869	3120	0	-3107	24587	3483	17997	31400	15235	82	55	5
99933	18922	0	13966	0	0	13966	219875	215308	1315	1036	40
80378	16908	0	21201	-7000	1000	12201	103987	123429	908	798	276
92857	10678	100	-3799	10700	0	6901	151694	146973	392	245	74
17589	11607	775	3810	0	0	3810	223565	206540	1305	870	1
95828	8403	-33343	-5888	3526	436	-1926	86241	75559	863	317	212
59525	35215	0	-27211	21310	0	-5893	56710	76525	295	295	160
36046	7665	130	-21575	4700	0	-16875	1	1	474	330	1

Total Operating Credit Needs	Total FmHA Operating Credit	Working Capital	Ca/Cd	Ca/Ta	Beginning Net Worth MC.	Ending Net Worth MC.	Leverage Debt/ Net Worth	Ta/Td	Td/Ta	Net Farm Income	Net Non-Farm Income
1353500	563500										
43861	33147	10506.06	1.50	0.30	-19148.89	-11370.98	-2.94	1.04	1.14	19997.19	9817.69
********Liquidity********					**********	**********	Solvency **********			**********	**********
150000		73099.00	1.58	0.45	-147300.00	-80072.00	-5.90	0.83	1.20	82020.00	0.00
60000		41801.00	1.30	0.21	-41937.00	29455.00	28.09	1.04	0.97	71331.00	3206.00
10000		9611.00	2.40	0.41	-21494.00	30793.00	12.12	1.08	0.92	66393.00	0.00
30000	30000	-19851.00	0.32	0.06	-176209.00	-132149.00	-1.77	0.44	2.30	44436.00	16297.00
120000		40777.00	1.22	0.44	-44962.00	-11450.00	-46.44	0.98	1.02	42081.00	14020.00
4500045000		68746.00	5.57	0.35	29559.00	42593.00	4.54	1.25	0.80	34204.00	19314.00
40000	40000	41764.00	1.55	0.33	3262.00	9636.00	35.61	1.02	0.98	37297.00	12996.00
		63997.00	8.25	0.26	41415.00	91579.00	2.48	1.40	0.71	33711.00	6023.00
55000	55000	15003.00	1.31	0.29	-80492.00	-87550.00	-3.60	0.72	1.39	34411.00	7630.00
40000		49175.00	2.49	0.43	28316.00	35988.00	4.26	1.23	0.81	14944.00	22713.00
		29869.00	4.23	0.32	38164.00	51255.00	0.68	2.48	0.40	17325.00	17737.00
		10083.00	1.16	0.23	-83690.00	-62360.00	-6.02	0.83	1.20	16108.00	20014.00
2000020000		-3847.00	0.81	0.07	35760.00	-4520.00	-38.78	0.97	1.03	13206.00	19507.00
1000010000		-10086.00	0.72	0.42	4803.00	16773.00	2.58	1.39	0.72	29829.00	0.00
20000	20000	16728.00	1.36	0.36	630.00	28123.00	5.24	1.19	0.84	30997.00	1500.00
40000		-8861.00	0.87	0.33	-23558.00	-12032.00	-15.46	0.94	1.07	28779.00	0.00
60000		19162.00	1.29	0.38	27415.00	28157.00	6.80	1.15	0.87	24500.00	4589.00
14000	14000	-13466.00	0.53	0.09	-30929.00	-22439.00	-0.34	0.88	1.14	4647.00	22937.00
25000		6352.00	1.07	0.30	34856.00	36864.00	7.52	1.13	0.88	24859.00	3364.00
20000	20000	23944.00	2.23	0.46	-22112.00	-3843.00	-25.69	0.96	1.04	20018.00	5342.00
50000	50000	6788.00	1.07	0.36	-229924.00	-205604.00	-2.47	0.60	1.68	22411.00	2183.00
50000	50000	-18964.00	0.78	0.34	-57647.00	-49039.00	-3.25	0.69	1.44	24233.00	387.00
18000	18000	3190.00	1.11	0.22	14782.00	22486.00	5.53	1.10	0.85	10168.00	3000.00
		3494.00	1.39	0.09	39734.00	44477.00	2.44	1.41	0.71	-9211.00	30877.00
8500	8500	11390.00	1.43	0.30	29825.00	43703.00	1.84	1.54	0.65	155.00	23183.00
18000	18000	-41237.00	0.25	0.30	-41554.00	-48942.00	-2.14	0.53	1.87	-5944.00	24987.00
20000		-10250.00	0.86	0.40	33427.00	16963.00	0.50	1.12	0.89	20634.00	0.00
40000	40000	2099.00	1.04	0.19	-10799.00	-3802.00	-75.80	0.99	1.01	9161.00	9000.00
5500	5500	-4444.00	0.36	0.06	3177.00	3728.00	10.38	1.10	0.91	-3107.00	24587.00
79500	79500	-21942.00	0.05	0.57	29765.00	34885.00	5.48	1.18	0.85	13966.00	0.00
40000	40000	-40834.00	0.59	0.20	-61533.00	-58280.00	-5.97	0.83	1.20	21201.00	-7000.00
130000		-8615.00	0.91	0.32	37561.00	29848.00	7.56	1.13	0.88	-3799.00	10700.00
50000	50000	11534.00	1.08	0.62	36060.00	-13901.00	-19.42	0.95	1.05	3810.00	0.00
60000		23594.00	1.43	0.36	43190.00	17817.00	11.10	1.09	0.92	-5868.00	3526.00
25000	25000	-37370.00	0.40	0.10	-27986.00	-49226.00	-6.09	0.84	1.20	-27211.00	21318.00
		-39518.00	0.16	0.23	-98135.00	-116217.00	-1.28	0.22	4.60	-21575.00	4700.00

29153.00	0.02	-0.14	0.95	-0.02	0.47	0.55	0.16	0.17	0.12	0.90	0.16
			*******	*******	Financial Efficiency and Activity**********						
Net Income	ROI NFI+Int-MD /IA MC	ROE NFI-MD/ Equity	MM Growth NI-MD/ MM MC	Profit Mg NFI+Int-MD /WFP	Turnover Ratio WFP/IA	Operating Operating/ WFP	Deprec./ WFP	Int./ WFP	Net Farm Income/ WFP	Market Td/(NFI+INT+DEP /Ta Mkt	
82028.00	0.20	-0.64	1.00	0.27	0.72	0.53	0.18	0.10	0.25	0.97	0.31
74537.00	0.10	1.70	0.75	0.24	0.41	0.58	0.10	0.10	0.20	0.68	0.12
66393.00	0.18	1.70	1.00	0.39	0.47	0.38	0.15	0.12	0.35	0.90	0.28
60733.00	0.39	-0.21	1.00	0.63	0.63	0.59	0.18	0.19	0.70	0.65	0.19
54470.00	0.08	-1.60	0.92	0.13	0.60	0.69	0.10	0.07	0.13	0.94	0.17
53438.00	0.10	0.29	2.43	0.21	0.48	0.55	0.05	0.11	0.30	0.75	0.20
45293.00	0.04	-0.17	1.00	0.10	0.39	0.47	0.15	0.12	0.28	0.65	0.14
43734.00	0.15	0.37	1.00	0.43	0.34	0.46	0.07	0.12	0.34	0.90	0.23
42041.00	0.08	0.18	1.11	0.16	0.49	0.29	0.10	0.30	0.31	0.78	0.20
37658.00	-0.04	-0.41	1.02	-0.09	0.41	0.58	0.12	0.10	0.19	0.44	0.09
35062.00	-0.03	-0.09	1.00	-0.07	0.41	0.26	0.25	0.07	0.49	0.35	0.29
32595.00	0.10	-0.08	1.00	0.39	0.25	0.40	0.06	0.33	0.21	0.72	0.09
30113.00	0.05	-0.15	-0.42	0.19	0.28	0.45	0.18	0.17	0.19	1.20	0.18
29620.00	0.25	0.71	1.00	0.19	1.29	0.48	0.10	0.04	0.38	0.74	0.69
29697.00	0.09	0.74	0.71	0.29	0.32	0.35	0.17	-0.08	0.56	0.71	0.17
28779.00	0.11	-0.87	0.91	0.21	0.51	0.54	0.05	0.09	0.32	0.88	0.20
28773.00	0.02	-0.13	1.00	0.03	0.58	-0.02	-0.02	0.06	0.19	0.57	0.09
25553.00	0.01	0.55	1.00	0.07	0.21	0.43	0.02	0.42	0.13	0.77	0.08
25023.00	0.06	0.04	1.00	0.16	0.38	0.50	0.15	0.14	0.21	0.74	0.16
24560.00	0.18	-3.36	0.96	0.23	0.80	0.49	0.19	0.06	0.26	0.74	0.29
24394.00	0.09	-0.05	0.50	0.22	0.42	0.45	0.22	0.15	0.18	1.25	0.17
24276.00	0.12	0.02	0.04	0.17	0.71	0.57	0.40	0.18	0.17	0.81	0.30
22468.00	0.03	-0.24	0.89	0.08	0.40	0.48	0.16	0.18	0.17	0.92	0.22
21416.00	-0.12	-0.58	1.00	-1.20	0.10	0.54	0.60	0.45	-0.59	1.06	0.07
20638.00	0.00	-0.13	1.00	-0.01	0.22	0.75	0.05	0.20	0.01	0.59	0.05
19043.00	-0.39	0.66	1.00	-0.65	0.60	0.40	0.47	0.31	-0.18	0.99	0.19
18634.00	-0.06	-0.85	1.00	-0.10	0.55	0.52	0.18	0.06	0.23	0.34	0.10
18161.00	0.05	0.53	1.00	0.16	0.29	0.57	0.13	0.18	0.11	0.76	0.09
17997.00	-0.41	-5.51	1.00	-2.56	0.16	0.78	0.23	0.46	-0.46	0.75	0.03
13966.00	0.11	0.15	1.00	0.18	0.59	0.72	0.04	0.14	0.11	1.13	0.22
12201.00	0.10	-0.19	1.00	0.24	0.40	0.63	0.05	0.14	0.18	1.53	0.19
6901.00	-0.03	-0.62	1.00	-0.08	0.39	0.86	0.07	0.11	-0.04	1.07	0.06
3810.00	-0.15	3.59	1.00	-0.20	0.74	0.68	0.24	0.06	0.02	0.94	0.21
-1926.00	-0.10	-1.65	1.00	-0.16	0.61	0.57	0.15	0.06	-0.04	0.47	0.05
-5893.00	-0.03	0.86	1.00	-0.11	0.27	0.57	0.31	0.52	-0.40	0.87	0.08
-16875.00	-0.66	0.25	1.35	-0.97	0.68	1.58	0.06	0.35	-0.98	3.72	-0.32

1.50	1.37	7.00	6.53	317.74	178.40	48.31	44.10	85.89	63.49	744.88	23946.15
Ca/Cd	Balance Available/ Td. pats.	Pre-App risk rating	Loan risk rating	WFP/OP. Acre	Cash Exp./ Op.Acre	Dep/Op. Acre	Int/Op. Acre	Withdraw/ Op.Acre	NFI/ Op.Acre	Debt/ Op.Acre	Debt/ Owned Acre
1.58	1.15	5	5	159.86	86.96	29.16	15.22	12.29	40.65	266.63	6647.63
1.30	1.04	5	7	400.65	268.11	41.00	41.01	24.22	81.24	942.29	1225.67
2.40	1.62	5	5	818.02	334.63	119.79	95.58	61.72	208.67	1622.43	4723.52
0.32	1.49	7	5	191.06	114.58	34.25	36.96	49.92	133.04	701.14	1099.44
1.22	1.19	7	5	297.79	166.97	29.81	21.39	22.70	40.15	507.41	4254.11
5.57	1.19	5	5	270.41	149.92	12.65	28.96	50.86	78.92	451.71	4833.27
1.55	1.02	4	7	234.99	142.52	35.21	27.47	67.45	64.64	584.76	932.55
8.25	1.73	5	5	307.44	192.93	22.64	36.08	11.23	106.01	636.36	4599.16
1.31	1.08	6	7	171.65	67.79	17.61	51.34	77.57	53.52	489.58	1967.49
2.49	1.72	5	5	238.99	160.16	28.97	24.08	92.45	46.27	474.36	733.10
4.23	4.84	3	3	708.86	217.90	178.00	46.56	439.42	346.50	893.26	34663.00
1.16	1.06	8	8	174.42	79.58	11.30	57.25	25.65	36.61	853.13	1564.08
0.81	1.08	9	8	506.16	232.16	92.01	87.71	91.49	98.55	1886.98	2528.55
0.72	3.51	8	5	1318.14	616.83	132.81	52.81	302.54	505.42	734.80	43353.00
1.36	1.96	5	5	214.81	68.08	37.19	-17.39	39.60	119.22	567.13	1843.16
0.87	1.07	8	7	258.77	144.34	13.01	23.95	52.91	83.42	539.16	4650.25
1.29	1.18	7	6	408.51	262.91	-6.36	24.39	88.43	77.29	610.77	1613.44
0.53	1.13	9	7	402.24	170.72	7.02	169.02	193.90	52.81	2127.86	2340.65
1.07	1.12	7	6	247.46	161.29	36.59	35.22	47.55	50.95	572.90	1451.74
2.23	2.68	5	5	521.34	269.80	96.73	29.99	48.57	137.11	676.14	98717.00
1.07	1.08	8	8	326.03	169.70	71.04	47.32	31.54	57.46	1303.82	2568.14
0.78	1.08	8	7	257.67	142.92	102.14	45.33	46.25	43.66	521.90	7241.38
1.11	1.09	7	7	142.26	72.58	23.38	25.24	37.71	24.56	300.37	1243.52
1.33	1.47	9	8	240.68	128.98	145.09	108.52	256.51	-141.71	1867.23	1970.36
1.43	1.14	7	6	197.01	374.32	9.15	38.53	42.35	1.14	592.72	80610.00
0.29	0.73—	8	8	163.71	109.18	76.93	50.39	127.69	-28.71	507.14	104977.00
0.86	0.89—	6	6	268.56	140.69	48.80	16.01	107.01	62.91	439.48	465.00
1.04	1.20	8	6	253.65	145.86	34.04	46.61	34.14	28.02	881.28	1200.74
0.36	2.06	10	7	124.04	101.33	27.91	56.73	317.20	-56.49	703.84	7742.20
0.85	1.02	9	8	128.21	97.08	4.72	18.26	8.53	13.48	184.49	4778.30
0.59	0.84—	9	9	148.48	92.26	6.77	21.19	12.47	26.57	443.79	1283.14
0.91	1.03	10	10	406.68	344.93	27.39	43.58	59.65	-15.51	920.83	3048.70
1.08	1.07	7	6	218.92	145.29	53.26	13.34	61.81	4.38	310.24	269911.00
1.43	1.14	6	6	415.41	226.53	64.35	26.51	73.97	-18.57	823.68	932.58
0.40	0.74—	9	9	228.91	128.49	70.71	119.37	52.02	-92.24	1016.08	1873.40
0.16	0.00—	8	8	66.68	94.04	3.95	23.23	22.59	-65.38	449.92	148475.00

Senator CONRAD. Now, you are saying 18 percent would be ineligible. That's fairly staggering news. How many borrowers do you have?

Mr. CLARK. 275,000.

Senator CONRAD. 275,000—so you are talking 50,000 farmers—50,000.

Mr. CLARK. That's an unfair comparison.

Senator CONRAD. Tell me how it's unfair—18 percent of 275,000 tells me 50,000.

Mr. CLARK. You have to go back historically and see what makes up our portfolio, and I've got to tell you the emergency loan, disaster loan program is heavily involved in that. And that would have no effect on those old, aged loans.

Senator CONRAD. Can you tell me how many loans, then, would be—how many borrowers would be made ineligible?

Mr. CLARK. I have to give you the figure that we—I think we did the study for 1986, about 18 percent of those, and I don't have those at my hand. I'd be happy to furnish those to you, too.

Senator CONRAD. Have you got a rough idea?

VOICE. Eighteen percent.

Senator CONRAD. Eighteen percent of what?

[Pause.]

Mr. CLARK. It really would be better if we gave you our detailed figures on it.

Senator CONRAD. That's an important number for us to have; I mean, here we have the attorneys general of four States, four of the States most affected. I have a great deal of confidence in the expertise of the people who worked on this, have met with them at length, and they have gone through portfolios—and, in fact, they come up with numbers as high as 70 percent because of the screening ratios. Now, you come up with a different number. I think it's important for us to know how many are affected.

I would like to know if potential applicants who are rejected by use of the preapplication risk ratios appeal, is there an appeals process?

Mr. CLARK. There is.

Senator CONRAD. And what would that be?

Mr. CLARK. Our normal appeals process. If indeed they are rejected because of those ratios, they appeal the process. It goes from the county supervisor to the district director, and it can be appealed to the State director.

Senator CONRAD. All right, let me ask this question. In section 1315 of the Food Security Act of 1985, Congress told you to release normal income security to farmers in an amount sufficient to pay the essential household and farm operating expenses as determined by the Secretary.

Have you ever issued guidelines to county offices to define the components of those expenses?

Mr. CLARK. We have.

Senator CONRAD. Could we be furnished with the copies of those guidelines and an evidence that they were in fact provided to county offices?

Mr. CLARK. Be happy to.

[The following information was received by the committee:]

Copy of Administrative Notice No. 1307 (1962) which went to all field offices on December 12, 1985, followed by Section 1962.17(b)(2)(i)(A) of FmHA Instruction 1962-A (Servicing and Liquidation of Chattel Security). This Section was added by Special Procedure Notice dated April 23, 1986.

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Washington, DC, December 12, 1985.

FMHA AN No. 1307 (1962)

Subject: Release of Proceeds from the Sale of Security for Family Living and Operating Expenses During Period of Processing Farmer Program Servicing Options Requested by Borrowers in Default.
To: All FmHA State Directors, District Directors and County Supervisors.

Purpose/Intended Outcome:

The purpose of this AN is to provide guidance to field offices and provide consistency nationwide on the release of proceeds from the sale of FmHA chattel security for family living and farm operating expenses for those borrowers in default on their FmHA Farmer Program loans. The outcome of the amended servicing regulations will be a consistent policy for releasing income from the sale of security property when such income is needed for family living and/or farm operating purposes.

Comparison with Provisions AN:

No previous AN has been issued on this subject.

Implementation Responsibilities:

In order to comply with paragraph 1962.17(b) of FmHA instruction 1962-A, a Form FmHA 1962-1, "Agreement for the Use of Proceeds/Release of Chattel Security," must be completed as soon as possible for all borrowers with loans secured by chattels. If a borrower has a current Farm and Home Plan, a Form FmHA 1962-1 must be completed to cover the time between today and the date the Farm and Home Plan expires. Planned sales shown on the Form FmHA 1962-1 must be consistent with planned sales shown on the Farm and Home Plan.

FmHA must continue to release sale proceeds in accordance with a completed Form FmHA 1962-1 until a borrower's account is accelerated. After an account is accelerated, no releases will be made under any circumstances.

If the Form FmHA 1962-1 expires after Form FmHA 1924-25, "Notice of Intent to Take Adverse Action," is sent but before acceleration, a new Form FmHA 1962-1 must be completed. In such cases, the County Supervisor should decide what expenses are necessary to meet immediate needs for family living and maintenance of the farming operation, and whether the borrower is able to meet these expenses with income from sources other than sales proceeds, such as income from an off-farm job. If these expenses cannot be met in any other way, then the Form FmHA 1962-1 will be completed to show planned releases of sale of security to meet these expenses. Releases for payment of capital expenses will not be planned unless absolutely necessary to preserve the government's security interest. If the borrower responds to the Form FmHA 1924-25 by asking for a rescheduling, deferral, etc., and FmHA is able to take some servicing action, the Form FmHA 1962-1 which was completed in accordance with this paragraph should then be revised to reflect the fact that FmHA will be continuing with the borrower.

If a borrower plans to make a change in the farming operation or plans to make sales which were not planned on Form FmHA 1962-1, the borrower will immediately notify the County Supervisor and the County Supervisor will revise Form FmHA 1962-1, if the planned income will be reduced or if the source of income is different than what was originally agreed on. If the borrower intends to quit farming, a revision to the Form FmHA 1962-1 will be revised to show this. See paragraph 1924.57(d)(2) of FmHA Instruction 1924-B and paragraph 1962.17(b)(5) of FmHA Instuction 1962-A.

If the County Supervisor and borrower cannot agree on a plan for the release of proceeds, the District Director will complete Form FmHA 1962-1 and the District Director's decision is not appealable. See paragraph 1924.57(b)(3) of FmHA Instruction 1924-B.

VANCE L. CLARK, *Administrator.*

Expiration Date: November 30, 1986.
Filing Instructions: Preceding FmHA Instruction 1962-A.
Attachment.

(2) Sales proceeds must be remitted to creditors with liens on the proceeds, in order of priority of those liens. Proceeds which are released by a prior lienholder or which are in excess of the amount due to a prior lienholder and which come to FmHA, can be used as follows:

(i) If a borrower *has* been sent a Form FmHA 1924-25, "Notice of Intent to Take Adverse Action," and the existing Form FmHA 1962-1 expires, a new Form FmHA 1962-1 must be completed.

(A) The form *must* provide for releases of proceeds from the sale of crops, livestock, and livestock products planned to be marketed in the regular course of business so that the borrower can pay essential household and farm operating expense. Essential expenses are those which are basic, crucial or indispensable. This will not include expenses for expansion of the farming operation. Excess proceeds must be applied to the FmHA debt or used to preserve existing security. If the sale of crops, livestock, and livestock products planned to be marketed in the regular course of business will not generate enough income to meet all essential household and farm operating expenses, the borrower may sell other chattel security (such as machinery, equipment or foundation livestock) to meet those expenses.

(B) Livestock can be used by the borrower's family for subsistence.

(C) Crops which serve as security may be marketed or fed to the borrower's livestock, provided FmHA obtains a lien on the livestock or livestock products.

(D) If the borrower responds to the Form FmHA 1924-25 and is granted a servicing action or prevails on appeal or makes restitution, the Form FmHA 1962-1 will be immediately revised in accordance with paragraph (b)(2)(iii) of this section.

(E) If the borrower does not respond to the Form FmHA 1924-25, is not granted servicing action, does not prevail on appeal or does not make restitution, releases will be made in accordance with paragraphs (b)(2)(i)(A)-(C) until the borrower's account has been accelerated.

(Added 4-23-86 SPECIAL PN.)

Senator CONRAD. You recently reported that you are sending some 26,000 Notices of Intent to Take Adverse Action to delinquent borrowers. Is that a correct number, as reported in the press?

Mr. CLARK. Approximately, yes.

Senator CONRAD. Twenty-six thousand Notices of Intent to Take Adverse Action. These notices are accompanied by a form that's styled 1924-14, which purports to tell farmers about the servicing options available from FmHA. I'd be interested in your explanation for the reason that FmHA did not include, with those servicing options, the following items: one, the dwelling retention program; two, the farmland leasing program and the special consideration for prior owners; three, the statutory programs for compromise adjustment and reduction of debt, liberalized by section 1309 of the Farm Security Act; and, four, the conservation easement program.

Is there a reason that these people weren't advised of these servicing options?

Mr. CLARK. Well, my first inclination in response would be that those are actions that follow liquidation. We cannot have a homestead offer until the account is liquidated, so there's nothing there that would affect the current status of their loan. That has no effect on cash flows or anything in that program. It's after the fact. It's a lifeline after the loan has been liquidated. So that would have no effect on it.

Senator CONRAD. But wouldn't it be well to advise farmers where the flow is taking them and what their options are as they proceed through the process?

Mr. CLARK. I think you will find that is happening. If you talk to some of our county supervisors, you will understand that we do talk about all those things here and now that will be part of their account with us.

Senator CONRAD. Well, let me tell you, the people who have provided me with these questions are the attorneys who deal with the farmers who are at the other end. And when you have a chance to review the comments from the attorneys general from the four States what you will find is an extraordinarily harsh condemnation of current process and procedures—inadequate notice, failure to advise of options—and I don't know where it's occurring. But I tell you I heard enough in the 4 days that we were out for hearings, the entire committee, and then in my own State of North Dakota, to know that somehow the word is not reaching those who it ought to reach—it's just not there. I have never heard so many complaints ever—and I was a tax commissioner, and I tell you, if you want to get complaints, you deal with the tax system. [Laughter.]

But I have never heard anything to rival what I've heard in the last several weeks—and we are going to hear much more today.

Mr. CLARK. I hope we are more responsive to our borrowers than my tax commissioner has been to me.

Senator CONRAD. Well, somehow I was responsive enough to wind up here, so some tax commissioners are sympathetic.

Well, Mr. Chairman, I have many more questions that I would like to insert in the record. Perhaps we can get to them on the next round. And also I have an opening statement.

One other thing, if I might. Just one example, in terms of problems with these regulations. The U.S. Code 1940(a), sub (A)(3), states that "Loans may be made to meet other essential farm operating expenses, including cash rent." Now, in my area of the country cattlemen rent grasslands for cash rent, retired farmers are renting. FmHA itself insists on cash rent. And now, in these regulations, as I understand it, in the face of long-established practice, FmHA proposes to prohibit loans for cash rent. Is that accurate? And, if so, what's the rationale and justification for that, which would appear to fly in the face of current law?

Mr. CLARK. It is accurate. I don't know about flying in the face of the law. We can find no exception to that. We really find some terrible experiences out there as we go through that. Land is bid up because the landlords know there's cash rent available through our program, and we find our borrowers bidding against other borrowers, and up goes the rent, which really works to his detriment, and, because of that terrible experience, we think that is a wise credit decision.

Senator CONRAD. You know, that's an extraordinary notion, it seems to me. All of a sudden we are ruling out certain legitimate expense items? Because cash rent can be abused, therefore it can't be considered an expense item? I mean, that to me is an extraordinary notion.

Mr. CLARK. Well, it might be in your mind; it's not in mine. I think the landlord ought to take a little gamble with that borrower, even sharing perhaps in the risk of that production.

The CHAIRMAN. I should note that Mr. Clark has to leave in a few minutes for Appropriations, and I want to yield to Senator Lugar, the ranking member of the committee. Not only will the record be kept open for questions, but I suspect that we will probably want to speak with you again.

I yield to the Senator from Indiana, Senator Lugar.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA

Senator LUGAR. Mr. Chairman, I just want to make a brief comment and say that I'm pleased you called this hearing to review the new Farmers Home Administration regulations. I'm aware that the issue was raised several times during your recent field hearings, and I am pleased that the committee is responding to concerns that have been expressed by so many farmers.

As you know, Mr. Chairman, it's a difficult issue to resolve. In my State of Indiana I note over half of all Farmers Home Administration loans are delinquent; in some offices, delinquencies run as high as 84 percent. I suppose none of us have a particularly good solution for dealing with these problems immediately, but we look forward to these hearings for our enlightenment and the enlightenment of all the constituencies, and we look forward to reviewing the regulations and other options for addressing this situation.

I have no questions of the witness, Mr. Chairman. I thank you for giving me this opportunity for an opening comment.

The CHAIRMAN. Thank you, Senator Lugar. I apologize to the Senator from South Dakota, who has also raised a number of questions. Because of Mr. Clark's schedule, we will to have to reschedule.

Senator DASCHLE. Could I make just one statement, Mr. Chairman?

The CHAIRMAN. Of course.

STATEMENT OF HON. THOMAS A. DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. I won't ask any questions, Mr. Chairman, but I share the frustration, the consternation, of my colleague from North Dakota and many others who clearly have indicated the disastrous situation that we find ourselves in with regard to farm credit. I was at the Finance Committee this morning on a mark-up, or I would have been here earlier. But if there is one message, it is that we have as serious a situation in credit in South Dakota as I have seen. The caliber of people that we have at the State office really needs to be examined by the Administrator. As a matter of fact, I've come to the conclusion that the only way that we can address this situation properly is for our State director to resign. I don't think that he has the wherewithal, the attitude, the kind of presence about him and his office that serve the Farmers Home in South Dakota very well. It's time for his resignation; it's time that we get someone who can address these issues directly, forthrightly, and with the kind of enthusiasm that we expect from the Farmers Home Administration. And the sooner that's done, the better.

And I thank the chairman for this brief moment.

The CHAIRMAN. Thank you. The Senator from South Dakota was one person who so consistently raised these issues during our hearings. I don't mean to be cutting off questions; we will reschedule another round with Mr. Clark if the Senators need it, and especially because of your great concern Mr. Daschle.

I do want to thank you, Mr. Clark. I know that you have tried to expedite the loan processing procedures, and I commend you for

that. I think that's very good. But I am concerned about the means used in the process; I am concerned that there has been a lack of consultation with this committee. And, frankly, I don't find that acceptable, and I will never find it acceptable. There must be consultation with this committee, with both the Republican and Democratic leadership.

I think there has been little attention given to the effect these regulations will have on farmers who will be cut off from credit. It's going to have a devastating effect on rural America.

I think we have a right to know what the implications are concerning this loss of credit. I don't think that we can stand by and let Farmers Home take these farmers off their farms. The Farmers Home, generally seen as their last hope, is now no hope. That's not acceptable to us.

I think there are illegalities in the proposal, and those can't be allowed. The comment period was so short I believe it was meaningless. I understand your concern about wanting to do it last June, but had the comment period been 30 days last June it would have been too short. I think the timing of the changes, in terms of their impact on farmers' borrowing decisions, is scandalous.

In the development of a training module, complete with tapes, whoever came up with this idea wasn't the least bit serious about the comment period. If they went to all the bother of having the audio cassettes and having this training module, they didn't expect one iota of change as a result of the comment period. They established a comment period simply because the law required it.

If you now publish a final rule, farmers aren't going to have any chance to comment. So I really must insist that we have another proposal without training modules and tapes, so farmers have a fair chance to comment.

I thank you for being here today. I suspect that we will have to ask you to come back—and I know that's something you look forward to with great eagerness. [Laughter.]

Senator MELCHER. Mr. Chairman.

The CHAIRMAN. Senator Melcher.

Senator MELCHER. Mr. Chairman, before Mr. Clark leaves, I'd like to make one suggestion, and that is that this committee be provided with information as to what percentage of the $30 billion in outstanding farm loans actually would stand scrutiny under normal banking procedures, normal banking examinations. I suspect that over half of the $30 billion in loans would have to be written off if the normal bank examiner procedures were followed.

The result is misleading the public, misleading this committee, and misleading Congress, as to the true status of Farmers Home Administration. Until we know that, I don't know how we can make very good judgments around this table as to what should be done.

[The following information from Vance L. Clark, Administrator, FmHA, was received by the committee:]

United States Department of Agriculture
Farmers Home Administration
Washington D.C. 20250

APR 2 1 1987

Honorable Patrick Leahy
Chairman, Committee on Agriculture,
Nutrition, and Forestry
United States Senate
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Secretary Lyng has asked that I respond to your letter of March 17, 1987, concerning regulations proposed by the Farmers Home Administration (FmHA) entitled, "General Provision of Farmer Program Regulations; Proposed Rule", 52 F.R. 1706 (January 15, 1987), attached are our responses to the issues you and other members of the committee have raised.

Again, Mr. Chairman, we want to assure you that the proposed regulations were issued in order that we might improve the ability of FmHA to deliver our supervised credit program in an efficient and compassionate manner to family farmers during these troubled times.

Please be assured that we will provide you with a copy of our final rules before they are published.

Sincerely,

VANCE L. CLARK
Administrator

Attachment.

FmHA Farmers Home Administration is an Equal Opportunity Lender
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, D.C. 20250

SUMMARY OF THE CONCERNS RAISED DURING
THE HEARING HELD BY THE SENATE COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY ON PROPOSED FmHA REGULATIONS:

In response to the first point in your letter, the proposed regulations do not circumvent present law, disregard due process or change the traditional and statutory role of FmHA as the lender-of-last-resort. FmHA was established by Congress to serve as a temporary source of supervised credit and technical support to eligible applicants who cannot qualify for commercial credit. In the past, loan approval decisions were made by using a variety of very subjective and different techniques including the completion of a Farm and Home Plan. This process had to indicate that the applicant could meet the financial obligations of the operation. The proposed changes will provide FmHA's applicants timely consistent credit decisions in accordance with our Congressional Mandate.

In response to your second issue, FmHA has never and does not now intend to issue the proposed regulations without fully considering the comments received from the public and responding to their concerns in the final regulations.

In order to provide timely training to the field, it is necessary to develop the training package as proposed regulations are being developed. Final training material will be consistent with the final regulations. Past experience has shown if proper training is not completed shortly after new regulations are issued, implementation is slow and very inconsistent, with and between States resulting in very poor delivery of our programs to the public. FmHA did conduct a meeting during the week of February 9, 1987. The purpose of this meeting was to brief the key members of our field staff on the proposed regulations, and to obtain their suggestions and input. It is the responsibility of the District Directors to provide training to the approximately 1900 County Supervisors and County Office staffs. Their input is paramount as to the content and presentation of the final training material.

1. COMMITTEE QUESTION: PRE-APPLICATION AND APPLICATION RISK RATIOS.

FmHA was established by Congress to provide credit to borrowers who cannot qualify for commercial credit. In essence, the proposed new risk ratios impose commercial credit standards on applicants for FmHA credit. This is inconsistent with FmHA's legislative mandate.

The proposed regulations would disqualify many of FmHA's present borrowers. Estimates of those who are currently borrowing from FmHA who would not qualify for loans under

the proposal range from 18% to roughly 50%. Such disenfranchisement does not appear to be consistent with the mission of FmHA. While some means to provide speedier turnaround of applications is necessary, it is essential that any proposal for screening incorporate explicit appeal procedures and be supported by careful evaluation of the impacts of the decision criteria on the eligibility of potential FmHA borrowers.

FmHA RESPONSE:

RISK RATIOS:

The proposed regulations will be revised to exclude present FmHA borrowers from the pre-application risk evaluation.

The proposed regulations set forth two sets of ratios to determine risk and expedite the application and decision making process. These standard farm ratios which are widely recognized as farm financial management tools, measure the proposed operation's solvency, profitability and liquidity. These ratios point out the financial weaknesses that the operation must overcome. The ratios will identify those farming operations that cannot overcome their financial difficulty. In addition, these management tools will reduce the application processing time of the county office staff, by identifying those applications that will ultimately be rejected after complete development of a loan docket. Savings on staff time will allow the County Supervisor to provide supervision to existing borrowers who desperately need assistance, if they are to have any hope of saving their farming operation.

In keeping with our purpose of considering the credit needs for those farmers who cannot get credit elsewhere, the risk standards which FmHA propose are well below the standards which commercial lenders use in making credit decisions for agricultural borrowers. While many agricultural lenders are still relying on cash flow to determine if they will stay with a farm customer, they are also relying more and more on ratios to indicate the trend the farming operation is taking. As one agricultural lender put it, "ratios are what you build your hypothesis on and the cash flow will bear out the results of the ratios." For example, an FmHA applicant with a debt/asset ratio of .7 or higher, a return on assets .1 or higher, and a current ratio of 1.25 or higher, will pass our proposed risk standard. The risk factor in this case would be 8 under our proposed risk evaluation formula. A commercial bank will not normally lend to any person having a score above 4. An FmHA applicant with a debt/asset ratio of .4 or less, a return on assets of 10 percent or higher, and a current ratio of 1.5 or higher, could almost certainly obtain credit from a conventional lender. The risk factor in this case would be 4 under our proposed risk

evaluation formula, and the applicant would be notified to seek other credit. FmHA will provide loan guarantees for such applicants, if no commercial lender is willing to independently extend credit. At a score of 10, a borrower is insolvent, with little or no capital and can not possibly recover. It must be noted that a debt/asset ratio of .7 requires a return on assets of 3.5 percent in order to pay just the interest on a loan with an interest rate of five percent. An interest rate of ten percent requires a return on assets of seven percent to pay interest only. We believe our proposed risk evaluation proposal is very reasonable and will identify those applicants who do not have any chance of success. (See attachment A for the percent return needed to pay interest only at various interest rates and levels of equity.) We see our proposal as being fully consistent with the legislative mandate of being the lender of last resort. We would be providing our supervised credit to those farmers who cannot meet the risk standards at commercial sources, but do have a reasonable chance of success with our intense financial management supervision.

Due to the concerns that a farm family, which depends in part on off-farm income to have a successful operation, would not receive credit for this source of income in the pre-screening process, we will add off farm income to the return on asset ratio. This will assure that off-farm income will be recognized as a return to the families efforts, and finally, to provide for an orderly transition to these financial screening processes, we will not implement the pre-risk evaluation process until FY 1989.

2. COMMITTEE QUESTION: SURPLUS PROPERTIES.

FmHA has acquired many hundreds of thousands of acres of farmland nationwide. Due to its policy of starting adverse action proceedings on all farmers who are $100 or more delinquent for one year or more, FmHA will probably acquire much more land in the future through foreclosures or conveyances. The critical issue in farm states is to whom FmHA will sell this farmland. FmHA has historically adhered to a law that requires it to restrict its sales of acquired farmland to family size farms for a three-year period after acquisition. The proposed regulations would permit FmHA to auction its farm land to the highest bidder after only one year. This is in clear derogation of the law and the historic mission of FmHA to help protect rural community and foster family farms.

FmHA RESPONSE:

SURPLUS PROPERTY:

Until recently, FmHA had few problems with inventory farms. When a farm came into inventory, there were always eligible

farmers in the area ready and willing to purchase the farm. The optimism of inflation during the seventies resulted in marginal acres being placed into crop production with FmHA, along with other lenders, providing the capital to purchase these marginal lands and establishing farm units on these lands. With the increase in production resulting in the lowering of prices received by the farmers, many of these marginal units are no longer profitable. Lower profit margins have resulted in fewer farmers willing to purchase these marginal farms. This has resulted in a large increase in acreage which lenders now control.

FmHA's present regulations require that any property that is determined suitable for a family farmer, must be declared surplus after 3 years if not sold to a family farmer. The current regulations also provide that the State Director may declare the property surplus at any time within the 3-year period if an eligible family farmer cannot be found or if circumstances change to where the property is not a feasible unit. Our proposed regulations reducing the time frame for declaring farm property surplus is based on a GAO report, "Farmers Home Administration, Federally Acquired Farm Property Presents a Management Challenge", dated June 1986, which recommended that the Secretary direct the Administrator to issue a policy directive that "when suitable property is not sold within a specified time, perhaps 1 year, because of a lack of eligible buyers or economic conditions, it be reclassified as surplus property. The Agency revised its regulations as proposed.

Past history has indicated that the majority of the farms, which FmHA takes into inventory, are not sold within the first year. Those properties which are not sold within this time frame are a financial burden to the Government and in many cases, the buildings and the land deteriorate to where it becomes a distraction to the community, resulting in further decline in community land values.

In addition, our increasing farm inventory stagnates sales as prospective land buyers hold off buying, waiting for the anticipated Federal Government bargain basement sales. Marketing our inventory farms will add strength to the farm land market, a condition desperately needed.

In view of the 13 unfavorable comments received, we are reconsidering our proposal and expect to continue with our existing regulations without change.

3. COMMITTEE QUESTION: USURPATION OF THE ROLE OF COUNTY COMMITTEES.

The proposed regulations would allow FmHA staff members to usurp the historic role of FmHA county committees in determining who is eligible to apply for FmHA loans. The

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rules allow state FmHA staff members to overrule favorable decisions of the committees and otherwise restrict the exercise of judgment of the county committee. Further, the use of mechanical ratios to determine eligibility obviates any meaningful decision making role for these committees. Historically, the role of the county committee has been to assess the managerial and personal characteristics of applicants. We are concerned that mechanical use of financial ratios will preclude applicants who have the potential to be successful farmers from receiving FmHA funding.

FmHA RESPONSE:

COUNTY COMMITTEE ROLE:

We have had, and still have, cases where a county committee has been coerced into determining an applicant eligible by the pressure the applicant can bring to bear in a community. As a result of this action, ineligible applicants receive FmHA assistance. It is our opinion that by allowing the State Director the authority to overturn these decisions, it would assure that only eligible applicants receive our assistance.

Your deep concern on this issue has caused us to re-examine our proposal. Based on that re-examination, we will remove the authority to overturn a county committee decision from the proposed as well as the existing regulations.

4. COMMITTEE QUESTION: ECONOMIC BARRIERS TO SUCCESSFUL FARMING BY FmHA BORROWERS.

It is essential that FmHA borrowers be permitted to operate their farms on a comparable basis with non-FmHA borrowers. The proposed regulations would thwart FmHA borrowers' potential for success by such actions as: prohibiting loans for advance payment of cash rent (in clear contravention of statute), prohibiting the use of loans to expand production of commodities declared to be "in surplus", prohibiting further loans for production in excess of the lower of the borrower's average production over the past two years, prohibiting replacement of foundation livestock herds with line of credit guarantees, requiring cash reserves in amounts equivalent to depreciation allowances, limiting the use of balloon payments, and requiring pledges of all assets for any loan.

FmHA RESPONSE:

FmHA does not believe the proposed regulations pose any economic barriers to FmHA borrowers.

PAYMENT OF CASH RENT:

The proposed change in payment of rental fees would not prohibit the use of proceeds from the farming operation to pay cash rent. In the past, it has been alleged that FmHA has contributed to the upward pressure of land rents by loaning money to farmers to pay cash rent. We believe the proposal to not allow loan funds to pay cash rent will help to keep rental rates at reasonable prices; reduce amount of loan funds needed for operating expenses, share the risk, and also reduce the amount of interest a farmer pays.

In view of your deep concern on this issue, along with the 24 comments relative to our proposal, we propose to provide 50 percent of the total rental cash for cropping operations. The tenant will be able to borrow this 50 percent and apply it up front with the remaining 50 percent being released from crop proceeds.

SURPLUS COMMODITIES:

The restriction on guaranteeing loans to increase production of agricultural commodities which are in surplus are in line with FmHA's present regulations governing insured loan programs.

The agency's mission is to help family farmers become successful. In our opinion, a continuation of lending monies to farmers to produce commodities, which are in surplus, only adds to the problem as the farmer will strive for maximum yields to increase his/her profitability but in the end, due to low prices, receives less for the commodity than originally anticipated. Many countries, which in the past depended on the U.S. farmer to provide agricultural commodities, are now in direct competition with our farmers for the world market. This has resulted in many of the commodities which in the past were able to turn a profit for the farmer, now have to be subsidized.

Due to the considerable objection to our proposal to reduce surplus production, we will remove this initiative from our proposed and existing regulations.

REPLACEMENT OF FOUNDATION STOCK:

Under the guaranteed loan program, FmHA has a Loan Note Guarantee and a Contract of Guarantee. The Contract of Guarantee is designed to provide a typical line of credit for up to 3 years. Since the lender is independently responsible to finance an operation for up to three years under this authority, it is our contention that loan purposes under this authority should be restricted to annual operating expenses. The Loan Note Guarantee which can be for a term of 7 years when used to replace foundation stock, is a much better type of loan than a line of credit.

CASH RESERVES:

The proposed regulation regarding cash flow provides that cash flow must indicate that a borrower has a balance available to provide for replacement of farm equipment, which is necessary for continuance of the farm operation. Our goal is to provide supervisory credit and to help the family farmer manage for financial success. It is important that we provide realistic guidance if we are to help the farmer to realize and understand the importance of establishing such a reserve to cover replacement costs which will occur throughout the life of the farming operation.

The use of the term "depreciation schedule" is not correct and we will revise our regulations to clearly indicate that the farming business must produce enough income for the normal replacement of farm equipment such as tractors, combines, etc., and foundation herds. Our past failure to take this into consideration in farm budgets has caused us to extend credit when the business was doomed to failure at the onset because worn out equipment could not be replaced.

BALLOON PAYMENTS:

The practice of ballooning payments can be very dangerous to the borrower as it provides for reduced payments in the beginning and a farmer can be deceived into thinking his/her financial condition is in a stable condition. It is also an excellent way to hide increasing debt in failing operations. When the balloon comes due, the farmer will be faced with debt which cannot be refinanced, resulting in liquidation of the farming business. The proposed regulations do not limit the use of balloon payments. They do set forth requirements that adequate security will be available at the end of the balloon period. Our proposed regulations refer only to real estate security. We will expand our security requirements to include foundation herds and other chattel security to provide for the possibility of balloon payments for tenant operation. The objective of FmHA's Farmer Programs is to provide credit to those applicants who cannot obtain credit from commercial sources only to the point where the applicant can graduate to other credit. Adequate security when the balloon payment is due, will assist the borrower in graduation and also reduce losses, should the farm borrower be unable to meet the payment.

PLEDGE OF ALL ASSETS:

FmHA was established to consider credit to otherwise eligible farmers who are unable to obtain credit from commercial sources. The proposed requirement for pledging of all assets, does, in our opinion, protect the farmers' overall financial interest as it provides FmHA full control

of the financial decisions. It reduces the possibility of a farmer obtaining outside credit above and beyond the farmer's ability to pay which immediately places the FmHA loans in jeopardy. FmHA supervised credit demands some restrictions. We have release and subordination authority to handle the borrower's need for credit from other sources. It is surprising, how many applicants find other credit when they find out we require a lien on all assets. We have learned this the hard way in our Emergency loan program.

Your deep concerns on this issue, along with that of the 18 respondents to our proposed regulations, has caused us to re-examine our proposal. Based on that re-examination, we will remove the requirement of pledging all assets to secure an FmHA loan, recognizing that we will increase our losses by doing so.

5. COMMITTEE QUESTION: BARRIERS TO BEGINNING, LOW EQUITY, AND RE-ENTRY FARMERS.

FmHA has proposed a number of regulations (in addition to the risk assessment ratios) that would impede beginning farmers, low equity farmers and re-entry farmers. For example, FmHA would require three years' experience in operating and managing a farm within the last five years before a farmer would be eligible to apply for a loan. It would also require preferences for existing borrowers, and, prohibit loans except in limited circumstances, to an applicant who has previously entered into debt settlement with FmHA. Further, these regulations will in general prohibit extending credit to borrowers whose previous obligations have been discharged through bankruptcy proceedings.

FmHA RESPONSE:

CURRENT EXPERIENCE:

The proposed rule which would require three years' training or experience on operating and managing a farm will not impede beginning farmers. Those applicants who have received agricultural training in 3 of the 5 years preceding the year of application would be eligible. The training could be in the form of Future Farmers of America, 4-H clubs, agricultural college experience or as hired labor on a farm. As you know, the county committee makes the final determination as to what constitutes adequate experience and if the experience justifies making the applicant eligible for assistance. It is the intent and purpose of our proposed regulations on the matter to provide some guidelines to county committees and to achieve consistency between various State and County jurisdictions. It is only logical when you prepare a loan in 6 figures, that the applicant have the basic training and experience which

warrants a reasonable chance of success. Past experience has taught us that applicants who do not have recent training in this complex business have a high probability of failure.

Based on your concern and the 12 comments received about this requirement, we will modify the experience requirement to require experience during the 5 years immediately preceeding the application. The county committee will determine if the experience is adequate.

PREFERENCE FOR EXISTING BORROWERS:

As a lender of last resort, we feel FmHA has a responsibility and an obligation to stay with its present borrowers whenever possible. We think it makes good sense to take care of our existing borrowers, who are still in need of supervised credit to assure them of being successful, before considering any additional caseload. As you know, our caseload per employee, exceeds by several times, those carried by the loan officers of other lenders. This change does not mean no new applicants, but it will allow us to continue our commitment to and protect our investment in existing borrowers before accepting new borrowers that we cannot properly supervise.

PROHIBIT LOANS TO BORROWERS WHO HAD LOANS DEBT SETTLED:

The proposed regulations will not prohibit loans to borrowers who have experienced debt settlement foreclosure or bankruptcy. Those borrowers who have been put out of business because, of conditions "beyond their control", i.e., weather, markets, illness, etc., will be considered for FmHA assistance. The public has placed a trust in FmHA to assist those farmers who have a reasonable chance for success. The public confidences surely will disappear if we attempt to re-establish farmers who cannot or will not try to manage the farming operation. Former borrowers, who re-apply for assistance and are rejected, will still be able to appeal the decision and to present evidence as to why the settlement of their debt was beyond their control.

6. COMMITTEE QUESTION: REQUIRING COUNTYWIDE DISASTERS PRIOR TO REAUTHORIZING FOR EMERGENCY LOANS.

The proposed regulations would not allow disaster loans unless the county, as a whole, suffered a qualifying 30% disaster loss. The law establishing disaster payments was intended to apply to both widespread disasters and more isolated disasters that injure only individual farmers or small groups of farmers.

FmHA RESPONSE:

The 30 percent criteria is not a change from existing policy and existing FmHA regulations. The 30 percent requirement has been in FmHA regulations since January 11, 1983.

In cases where it is determined a county(ies) does not qualify under the 30 percent criteria, additional information is obtained for consideration under the Secretary's discretionary authority. Under this authority, the Secretary may designate a county(ies) when there are extenuating circumstances which show that one or more farmers suffered qualifying losses as a result of an adverse and isolated weather condition(s) and cannot obtain needed credit from other lenders in the area.

7. COMMITTEE QUESTION: APPRAISALS.

In derogation of the law which requires FmHA to promulgate regulations to implement the FmHA appraisal process, FmHA proposes to simply delete the regulations on appraisals from the code of federal regulations.

FmHA RESPONSE:

APPRAISALS:

Appraisals are an administrative function, which the law allows.

FmHA is not deviating from the law; nor abandoning the standard principles of real estate appraisal. FmHA will continue to use the three major factors that must be considered in arriving at the best estimate of value of farm real estate. These are (1) market data approach, (2) capitalization approach, and (3) the summation approach.

We will however, in response to your interest and the 12 comments received on this issue, continue to include the appraisal process in our regulations.

8. COMMITTEE QUESTION: MIX OF OPERATING AND OWNERSHIP LOANS.

Farmers Home appears to be moving rapidly to position itself as a supplier of operating credit, and to the point of discontinuing farm ownership (real estate) loans. While operating credit concerns may be the primary issue in this particular phase of the business cycle, abandoning the ownership programs may have serious long term implications. The committee would like to see evidence that movement in this direction is warranted.

FmHA RESPONSE:

FUNDING POLICIES:

As you know, the "official" lineage of FmHA goes back to April 30, 1935. The major thrust of the farm ownership loan program, at that time, was to solve the problems of poor tenant farmers on poor farms. Their loans were a part of a Government-wide effort to help needy rural people re-establish themselves on a self-supporting basis.

Our priorities are still the same as they were in 1935 in helping farmers to become successful. The circumstances have changed to where today the need of the farmer is operating credit. Thus, we believe that the original intent of the farm ownership program has been accomplished. This is evidenced in the fact that a major portion of our present farm ownership loan funds are being used for refinancing purposes.

Investment in land, yields a lower return over the short run, as compared to investment in production inputs. Most beginning farmers have limited resources and need to invest these resources where the highest returns will be obtained. After they have established a sound financial base and have accumulated some capital, they may wish to invest some of their resources in land purchase. We believe that the traditional commercial sources of credit will be available for those young farmers who have established themselves and have demonstrated ability to manage their farming operation.

Credit programs to assist young and beginning farmers should be directed toward providing operating type credit to assist them in becoming established in farming. Once the young farmer becomes soundly established, and has acquired some surplus capital, long term credit will be readily available from commercial sources for purchasing farm land.

Anticipated passage of the pending legislation regarding the Secondary Market Improvement Act of 1986, will once again make long term lending attractive to lenders who are not now active in real estate lending. It will provide the incentive of increasing profits for these lenders when they participate in the Agency's guaranteed loan program and provide an adequate source of farm ownership credit.

Another factor in the discontinuance of the Agency's long term credit program is to reduce the long term subsidy cost of the loans. We believe this has merit as the effort to reduce the Federal deficit continues to be a high priority of the Nation's taxpayers.

Attachment A

PREAPPLICATION RISK EVALUATION

Percent Return Needed on Total Investment

To Pay Interest Only at Various

Interest Rates and Levels of Equity

INTEREST RATES

% EQUITY	5%	10%	15%	20%
100	0	0	0	0
90	.5	1.0	1.5	2.0
80	1.0	2.0	3.0	4.0
70	1.5	3.0	4.5	6.0
60	2.0	4.0	6.0	8.0
50	2.5	5.0	7.5	10.0
40	3.0	6.0	9.0	12.0
30	3.5	7.0	10.5	14.0
20	4.0	8.0	12.0	16.0
10	4.5	9.0	13.5	18.0
0	5.0	10.0	15.0	20.0

Source: John P. Reagan, President, Lafayette Production Credit Association

The CHAIRMAN. We will stand in recess for about 5 minutes, and then we will come back to discuss a sad matter for the committee.

[Brief recess.]

The CHAIRMAN. The committee will reconvene.

We call our next panel. This includes Ron Allbee, the Commissioner of Agriculture from the State of Vermont—I don't know why I'm looking down at my notes to find out from which State Ron is the commissioner. Ron served for a number of years as my chief LA on agricultural matters, and I'm delighted to have you here in your role as Commissioner of Agriculture of Vermont. Ron will be joined by Frank Kirschenheiter, who is the chairman of the Credit Review Board of North Dakota in Bismarck, North Dakota, and by Dianne Thomas, who is the Farmers Home Administration county supervisor, Donaldsonville, Seminole County, in Georgia.

I would note that I will have to leave the committee shortly for another committee meeting, but I know that Senator Melcher is here, Senator Fowler is here, Senator Daschle is here, and Senator Conrad has also agreed to stay. There will be various Senators taking the chair.

To show how totally fair I am, we will begin and go alphabetically with Commissioner Allbee. If his name didn't start with an "a," I would find another reason to start with Commissioner Allbee.

Ron, go ahead.

Mr. ALLBEE. Thank you, Mr. Chairman. I just want you to know that it's not just a pleasure to appear before you, but it's a pleasure to have you sitting in the chair today, and every day I hope for a long future.

We are certainly proud that you are extending leadership that we recognize in Vermont to the Senate Ag Committee, and I just want to register that for the record.

The CHAIRMAN. Thank you.

STATEMENT OF RON ALLBEE, COMMISSIONER OF AGRICULTURE, STATE OF VERMONT

Mr. ALLBEE. I do have a prepared statement, but I'm not going to read from my prepared statement. I will try to be brief for the record.[1]

I want the committee to know that Farmers Home is a big lender in the Northeast. Farmers Home, on the real estate side, accounts for 32 percent of the credit in the Northeast, second only to the Farm Credit System. In the State of Maine alone, Farmers Home accounts for over 60 percent of the real estate credit offered in the State of Maine.

So when we look at Farmers Home, we are looking at a major lender to the ag people in the Northeast, a lender that has become more important as the commercial credit has withdrawn from lending activity in our State and in other States in the Northeast.

There are four concerns—probably more—but there are four concerns that I will address on the regulations. First, I am concerned about the preapplication process. I think for our overburdened farmers it's just another paperwork hurdle.

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[1] See p. 91 for the prepared statement of Mr. Allbee.

I would argue that the ratios, although ratios can be a convenient measurement, the ratios themselves do not look at management ability, a person's experience. Beyond opposing the preapplication, I would say that the ratios in themselves should not be the only item to look at in terms of lending.

Second, balloon payment changes on chattel mortgages concern me. As I read the regulations, it will reduce the lenders flexibility in offering chattel loans to our needy farmers, and I think that flexibility should not be reduced, certainly in this day and age.

Third, surplus production, as I read the guarantee portion of the regulations, the director or a State may not offer loans if it is to increase production of a surplus commodity. Again, that's a concern to me in Vermont, because, even though we have a national dairy surplus, New England is not in a surplus position on dairy; in fact, we are looking at building value-added product plants, and if we do build those value-added product plants, such as Brie cheese plants, we may need some more dairy production; we may need loans to our farmers. I would like to see that regulation regionalized such that there was some discretion.

Finally, the State director's authority is expanded: the State director can overturn a positive recommendation from the county committee. I would only ask if the intent is to do away with county committees, then so be it, do away with them. But I see those people as very capable lay people that offer good advice, and I do not want to see the State director's authority expanded.

I am sure there are other things that I should speak to, but those are the four things that are there that are of major concern. But, again, I do want to impress on the committee that Farmers Home is a major lender, that the States cannot take up the slack, and I want to see Farmers Home as a viable strong lending agency.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Ron. Frank Kirschenheiter, chairman of the Credit Review Board of North Dakota, please proceed.

STATEMENT OF FRANK KIRSCHENHEITER, CHAIRMAN, CREDIT REVIEW BOARD OF NORTH DAKOTA, BISMARCK, ND

Mr. KIRSCHENHEITER. Thank you, Mr. Chairman. I'd like to thank the committee, and I'd like to thank Senator Conrad for the invitation to appear. I am chairman of the Credit Review Board. We work to negotiate debt settlements between farmers and borrowers in North Dakota. I would also like to thank many farmers, ranchers, and business people in North Dakota who contributed $10 apiece to send me here.[1]

We are concerned about Farmers Home and their future. North Dakota uses Farmers Home extensively. When I heard some of the figures that Mr. Clark gave this morning, I was appalled because it seems that we probably have a fourth of some of those. So we have an active Farmers Home.

Some of the things I wanted to touch on, obviously, are the cash rent. In North Dakota, cash rent is almost the sole means of rent-

[1] See p. 92 for the prepared statement of Mr. Kirschenheiter.

als. Most of the cash rents, including myself—I rent from four different people, they are all retirees, they need to have their money, they can't take the risk and wait until fall. To think that the fact that Farmers Home is saying they were out there chasing rents up—the county supervisor's job is to establish what that farm borrower is able to pay for that cash rent. I can't see that that would have any effect at all.

I would like to attest to the fact that Vance Clark has been out in the field. Last June he was in North Dakota and visited with some senior negotiators and myself, and we expressed to him the need to have some regulations with logic in them as far as restructuring and reamortizing debt. Although it was concurred that perhaps there was need for those regulations, the comment that was made was—and I quote it: "But, if there were logic in the world, man would ride side saddle." At that time he was brisk out of the room.

I suggest that if Farmers Home did come up with regulations with logic, we'd all ride side saddle tomorrow. It's just appalling to hear that those kind of remarks are coming from this administration.

I'd like to touch on the fact of Farmers Home employees. In North Dakota we have by and large good Farmers Home employees. They are to be commended. The work that's done in the State office is to be commended. The problem seems to be in the regulations that are coming down from Washington to take away the lender of last resort, and to give us something that is nothing more than a collection agency in the country.

I have offered to you prepared testimony. I will close on what I've given you. I hope you consider what we have. We have also enclosed the testimony that the Credit Review Board has done and prepared for Farmers Home on the comment period. The fear we have is the intent that you expressed earlier, Mr. Chairman, that if these things are not considered, and we have regulations as of a week from now, what have we got? We want to be certain that all of the input is considered and that it doesn't just go through a shredding machine.

Thank you.

The CHAIRMAN. Thank you very much. I would note for the record that we have a statement by Senator Boren,[1] who will not be able to stay for the whole meeting. Without objection, that will be made a part of the record.

Ms. Thomas.

STATEMENT OF DIANNE THOMAS, FmHA COUNTY SUPERVISOR, DONALDSONVILLE, SEMINOLE COUNTY, GA

Ms. THOMAS. Good morning, Mr. Chairman. I'm Dianne Thomas, the Farmers Home Administration county supervisor in Seminole County, Georgia.

Seminole County is located in the southwestern corner of the State of Georgia. I'm a career employee of Farmers Home, and started my career as a county office assistant in my home county,

[1] See p. 89 for the prepared statement of Senator Boren.

Miller County, which is next door to Seminole, the county that I'm now working in. This was 15 years ago, after attending Valdosta State College. I worked at different jobs in the county office and was promoted to county supervisor in the Seminole office in 1984. Except for temporary duty at other times, my whole FmHA career has been in Miller and Seminole Counties.

Seminole County is not considered a large county by FmHA loan standards. It has about 275 farmers altogether, one-third of whom are our borrowers. Farming generally consists of row crops and livestock enterprises. The main cash crop is peanuts, followed by cotton and soybeans. A new cotton gin was built recently. The county has 65,000 acres of cropland, with 50,000 acres irrigated. Water is plentiful for many farmers because of Lake Seminole created by the dam on the Chattahoochee River.

Our farm borrowers together hold about 440 loans from us, and about 46 percent are delinquent in their payments. Last year we sent notices to 36 farmers that something needed to be done about their accounts, and 75 percent of these cases have been resolved in one way or another, and the others are awaiting acceleration. In 1987 we've sent out eight Notices of Intent to Take Adverse Action.

We have not had a farm foreclosure by Farmers Home in at least 5 years in Seminole County, although we do expect to have our first notice published in the paper this week.

The farm borrowers and more than 300 rural housing borrowers together have an outstanding loan portfolio of about $30 million. The housing loan delinquency rate is currently just over 7 percent. That relatively low rate represents a fairly stable rural population in our county.

Mr. Chairman, I did not know that I was coming here until Monday, or I would have tried to prepare something more appropriate. I didn't have time to write a long statement. I just wanted to tell you what we are doing in Seminole County with Farmers Home Administration, and I want to thank each of you for inviting me.

The CHAIRMAN. Thank you. Let me just ask you one question, Ms. Thomas. Did you have any input into the development of these new regulations?

Ms. THOMAS. No, sir, I am not aware of the new regulations; I have not seen the new regulations.

The CHAIRMAN. You haven't had any of the training by Farmers Home?

Ms. THOMAS. No, sir, I don't know anything about them.

The CHAIRMAN. And, Commissioner Allbee, at the risk of sounding a tad parochial, what would be the impact of the reduction of the direct loan program on Vermont, in your estimation?

Mr. ALLBEE. Given that the Farmers Home accounts for 32 percent of our real estate lending, given that the State is trying to fill that gap—and Farmers Home has about a $100-million portfolio, the State's budget is $400-plus million—I see no way that the State could make up the difference. I think it would be very negative.

The CHAIRMAN. In your discussions with some of your counterparts around the country, would you say that Vermont is not unique in that? I mean, are other States facing similar problems?

Mr. ALLBEE. Absolutely.

The CHAIRMAN. I wonder now, in North Dakota, what's the ranking of lending agencies in their willingness to work, say, with your agency toward restructuring debt? How would you rank them?

Mr. KIRSCHENHEITER. We have a very favorable response with everyone we work with, be it the independent bankers, the corporate banks, or Farm Credit Services. Some of the numbers I might allude to are that Farm Credit Services since the first of the year has reviewed some 659 nonaccrual accounts, and they have brought to a means all but 250 of those. In the first 6 months of 1985, the independent bankers in North Dakota restructured debt to the tune of a $62-million loss.

It's obvious that chapter 12 is there and in place, and, given the economy, farmers cannot cash-flow more than current market value of assets or real estate. That attitude has prevailed and is prevailing in North Dakota among all lenders, with the exception of Farmers Home. And it's not because the county supervisors don't want to do it; they would love to do it. But the regulations prohibit them from doing it.

The CHAIRMAN. You anticipated my next question, and I appreciate your answer. I am going to turn the chair over to the ranking majority member of the committee, Senator Melcher.

Senator MELCHER [presiding]. Mr. Kirschenheiter, it bothers me that the Farmers Home Administration is making a relatively minor number of loan restructures. Is this somehow a deliberate move just to force people to get out of farming?

Mr. KIRSCHENHEITER. I'm addressing this from the standpoint of being a Farmers Home borrower myself, and the willingness of these county supervisors to restructure and re-am debt, which they were readily doing prior to this administration—since this administration there has been regulation after regulation brought down that ties their hands. County supervisors in our area are frustrated that they cannot do what they once were able to. Granted the farm economy has had a lot to do with that, because before they could restructure and they could show a cash-flow on the restructured debt. That debt has grown to where it cannot cash-flow with the restructuring even.

Senator MELCHER. Well, restructuring is, first of all, to be able to keep a borrower on the land, and then show that over time, with lower interest rates, they can come out. Isn't it also necessary to readjust any land loan involve in such a way that it will allow recovery?

Mr. KIRSCHENHEITER. Senator Melcher, I myself would concur in that. What has happened in the restructurings that have taken place in the past, the interest has become principal and the debt has grown. And unless there is an adjustment of that debt of just an all-out write-off of a portion of that debt, those farmers will not survive. North Dakota uses their limited resource rate extensively, and there are a great number of loans that are written at the 4½ percent, but with this accumulated debt they will not even cash-flow with that interest rate.

Senator MELCHER. So delay of restructuring makes the debt worse, and less opportunity to show a picture of recovery then?

Mr. KIRSCHENHEITER. That's true, sir.

Senator MELCHER. Is that true in Georgia also, Ms. Thomas?

Ms. THOMAS. We've had the authority in Georgia to restructure for several years, and in my office I have every year looked at a man's situation. If restructuring, reamortization, limited resource rates were needed to make him cash-flow, then that's what we did.

Senator MELCHER. Have you had any change in policy to make it harder to do so?

Ms. THOMAS. None that I'm aware of; we are still trying to reschedule accounts. At one time Farmers Home, if you could show paying back your operating loan and interest, we would be able to still operate a man. However, it has changed: the man has to be able to cash-flow. But any other changes I can't think of right now.

Senator MELCHER. Mr. Kirschenheiter?

Mr. KIRSCHENHEITER. AN Notice, Administrative Notice No. 1492, 1924, this year changed what had been policy in our State anyway, where you must show payment on all debt. Prior to that you could have set-aside debt, you could have nondisturbance agreements with lenders. As of this year, you must be able to show a payment on all of your debts.

Senator MELCHER. Even if some of the creditors are willing to accept this status of nondisturbance for a period of years?

Mr. KIRSCHENHEITER. Even if. As recently as last week I was working on a case where we have 7-year nondisturbance agreements in place, and our 1987 plan must show payment on those debts.

Senator MELCHER. With that kind of situation, what's the effect on the rural communities? I suspect that their plight is worsened by the fact that there is delay in operating loans.

Mr. KIRSCHENHEITER. Mr. Chairman, we in North Dakota and Credit Review Board being an institution, to so speak, to negotiate for the farmer—at this point we are more concerned about our small towns than we are for our farmers. Small towns all across North Dakota are losing businesses at a tremendous rate. They cannot survive. The farmers—somebody will farm the land. Obviously the small businesses, when they are gone, there is no incentive to open them up again.

Senator MELCHER. There was a national pool for direct operating loans in 1986. I think North Dakota got over $50 million in additional loan funds out of that pool, but just to the west of North Dakota, our State of Montana got about $6 million. That's not much.

How would you describe the difference? Is North Dakota Farmers Home Administration working harder than in Montana?

Mr. KIRSCHENHEITER. I heard the Senator from South Dakota earlier requesting the resignation of their State director. Our State director was very, very forceful in obtaining those additional $50 million. We've been fortunate in the past several years that they have done very well in getting money from the national pool.

Senator MELCHER. Is the State director a Republican?

Mr. KIRSCHENHEITER. I would assume so.

Senator MELCHER. Is he a rightwing Republican? [Laughter.]

Mr. KIRSCHENHEITER. I would reserve comment.

Senator MELCHER. Well, I know what we have in Montana, and I really don't object to anybody's political philosophy if it doesn't get in the way of executing the program. I think I'm not quite ready to

join with my good friend from South Dakota in asking for the resignation of our State director. I am willing to work with anybody and everybody in Farmers Home Administration, but I'm not willing to just sit here on the Potomac and watch Farmers Home Administration, through abuse of their prerogatives and lack of pursuit of what the law is, wash out farm families simply because of some hidebound attitude that we ought to wash a certain percentage out.

The Senator from Georgia?

Senator FOWLER. Ms. Thomas, as a fellow Georgian, I welcome you and thank you for your public service going back over 15 years. I'm sure all of us were impressed by your announcement that there had been no farm foreclosures in Seminole County over the last 5 or 6 years.

To what do you attribute that, besides your good efforts? Specifically, has there been anything done by the State office in coordination with your office to educate farmers on restructuring and rescheduling provisions that we ought to know about that has enabled you to have that record to date?

Ms. THOMAS. I think the one thing that's enabled it—of course, you are aware that we have been under a class action suit, and were unable to foreclose. [Laughter.]

Senator FOWLER. Well, I withdraw my question. [Laughter.]

Senator CONRAD. Would the Senator yield for a minute?

Senator FOWLER. I'd be delighted to yield.

Senator CONRAD. We are very proud that the person that brought that lawsuit is a North Dakotan, and we've had them stopped up pretty cold here. But, as you know, that day is passing. I just wanted to offer one thing that's just been handed to me. You recall the testimony that we had here that only 18 percent of FmHA borrowers would be affected. That's the testimony of Mr. Clark here this morning. I've just been advised that the GAO testimony, which we will receive later today, will indicate that in fact it is 50 percent of FmHA borrowers who would be made ineligible by these regulations.

I just thought the committee members might want to have that piece of information as we go through the questioning.

Senator FOWLER. I thank the gentleman.

Ms. THOMAS. Senator, back to your question, our State office has coordinated much training, they visited the field offices on the rescheduling-reamortization. We have all been encouraged to put it into play. Every farmer that walks in my door knows about rescheduling before he leaves, and reamortization. If it can be used to help him, it is done.

Senator FOWLER. Both in light of the work of the State office and your office, and in light of the class action, what if any prejudices would follow a farmer who debt-settles with FmHA, wants to continue to borrow production money on an annual basis?

Ms. THOMAS. I don't understand your question when you refer now to debt settlement. Are you talking about writing off debts and compromise and adjustment offers?

Senator FOWLER. Right. What position does that then put him in if he applies for production money the next year?

Ms. THOMAS. I don't know. I've not had that happen, so I don't know the answer to it.

Senator FOWLER. It's always refreshing to have that as an answer, when you don't know. Thank you.

A couple of other quick ones and then I'll yield. Tell me a little bit about your rural housing program. You said you had only a 7-percent delinquency on housing. My people tell me that in the last 5 or 6 years in Georgia that the number of homes built through rural housing programs has dramatically declined, even to the point that the State office is sending back the money.

Is that the case in your county, and have you seen any change in that trend?

Ms. THOMAS. Yes, sir, that is the case in my county.

Senator FOWLER. Why?

Ms. THOMAS. Unavailability of lots is one of the problems that I'm having. I think—this is my personal opinion—the income limitation on making these housing loans should be increased. There's a group of people that are right in the middle that aren't able to get financing from Farmers Home, yet they are unable to afford the payments of conventional lenders and a large downpayment. I think that has something to do with the income limitations that we are faced with, those that we can serve.

Senator FOWLER. I understand that, I understand what you say. Tell me about the lots, how would there be an unavailability of lots?

Ms. THOMAS. This is just a problem that we are having in Seminole County. Seminole County is in a hole, a lot of the county floods—we have some areas that are, you know, in a flood plain. So we just have a problem with it. Out in the county you have so many landowners that don't want to give up lots. I have no subdivisions existing right now that are being developed. I only have one local builder that is even expressing an interest in building Farmers Home houses. The builders are—we don't have as many builders as we did at one time, during the peak in the seventies of the housing program.

Senator FOWLER. I think I've used enough time. I yield, Mr. Chairman.

Senator MELCHER. The Senator from North Dakota.

Senator CONRAD. Thank you, Mr. Chairman. Just a couple of very quick questions, and then I will yield back my time so that the Senator from South Dakota has an opportunity before we go to the next panel.

Mr. Kirschenheiter, first of all I want to thank you for coming. It's important to us to hear from people who are dealing with farmers who are affected by FmHA policies. You were here in the room when I read the report from the four attorneys general saying that if adopted these proposed regulations would have a devastating effect on the farm economies of our respective States.

As somebody who is in the trenches and on the front line, do you think that statement is too strong? Do you have some sense of what the effect would be?

Mr. KIRSCHENHEITER. It certainly is not too strong; if anything, it could probably be stronger. There's a goodly number. One effect that it has, it almost restricts young farmers completely. North

Dakota needs to get new people on the land, and without Farmers Home there really aren't any other games in town.

Senator CONRAD. My second question would simply be: What in your experience is FmHA's current role in debt restructure? Are they actively, aggressively pursuing debt restructure in our State, or do they have a hands-off attitude toward debt restructure? How would you characterize their attitude toward debt restructure?

Mr. KIRSCHENHEITER. When I talk debt restructuring, and the work that I've done with independent banks and Farm Credit Services, debt restructuring at this point in time almost always involves a writeoff of some debt. In that aspect, they are completely mute. On another aspect, as far as the rescheduling and the re-aming, they are very active; they are willing to do that.

But page 1766 of these January 15th regs would eliminate a great deal of that.

Senator CONRAD. Would the gentleman from Vermont care to comment on that?

Mr. ALLBEE. My knowledge is hearsay, talking to some people involved in Farmers Home in Vermont. I wouldn't say they've been active. But I also have to say that we don't have the farm income problems that you do in the Midwest.

Senator CONRAD. Thank you, Mr. Chairman. I will give back my time and give Senator Daschle a chance.

Senator MELCHER. Senator from South Dakota.

Senator DASCHLE. Thank you, Mr. Chairman. I would just want to clarify a couple of statements made by Mr. Kirschenheiter with regard to the availability. I'm sure it's quite clear, as he has already discussed the availability of operating money—but what percent of current operating loans today is, as far as demand goes, being met? To what degree is the operating money today available to farmers in your area?

Mr. KIRSCHENHEITER. I would assume—and without having Farmers Home's numbers, it would be very difficult—but our allotment for Farmers Home direct OL loans this year was some $60 million. Last year we used $113 million. Now, just using the numbers—and obviously the demand for credit isn't going to be less—I would say we are probably going to be in that 50-percent shortfall.

Senator DASCHLE. Now, you had mentioned that your State Farmers Home director sought and was successful in obtaining an additional $50 million?

Mr. KIRSCHENHEITER. Last year, correct.

Senator DASCHLE. Last year. So you are stuck this year with about $50 million.

Mr. KIRSCHENHEITER. Fifty to sixty million—I don't recall the exact number.

Senator DASCHLE. What is your understanding of what will happen to those who don't receive operating money? What recourses do they have?

Mr. KIRSCHENHEITER. In North Dakota, the county supervisors by and large very actively use the subordination method, and if you are talking strictly operating loans, where the farmer is only borrowing that money for a period of 6 months, and it's subordinated to the bank, the difference on interest rates will probably only cost

that farmer, you know, anywhere from $300 to $1,000 additional for that year. And that method I'm sure will be used extensively.

Senator DASCHLE. Do you think that subordination will meet the needs of the 50 percent, then, who are not receiving direct loans from Farmers Home?

Mr. KIRSCHENHEITER. Probably not, insomuch as the 50 percent that haven't got their financing by now are not the 50 percent of the best farmers. You have the tougher cases left for last, the workouts that are left for last. And it will be rather difficult for those to get subordinations.

Senator DASCHLE. What happens in those cases, and what percentage of cases do you anticipate that might be?

Mr. KIRSCHENHEITER. We had a goodly number of farmers that we worked with with the Credit Review Board last year that basically with PIK certificates and Government payments financed themselves and just practically starved, but went through a year.

Senator DASCHLE. So in a sense you may be talking 15 or 20 percent of the farmers who cannot seek subordination, cannot get direct loans, who are relying in large measure on PIK certificates and other piecemeal approaches to financing, is that what you are saying?

Mr. KIRSCHENHEITER. That could be fairly close.

Senator DASCHLE. Thank you. Thank you all for your testimony.

Senator MELCHER. One last question, Mr. Kirschenheiter. We are not exaggerating to say that the crisis for credit this year for farm operators is worse than last year, or are we? What's your opinion?

Mr. KIRSCHENHEITER. If in fact Farmers Home in North Dakota comes up $50 million short of what they had last year, no, you are not exaggerating it, not in North Dakota.

Senator MELCHER. Thank you all very much.

Our next panel is the Honorable Hubert H. Humphrey III, attorney general, State of Minnesota; the Honorable Nicholas Spaeth, attorney general, State of North Dakota; the Honorable Roger Tellinghuisen, attorney general, State of South Dakota; and the Honorable Robert Spire, attorney general, State of Nebraska.

Senator DASCHLE. Mr. Chairman, if I could get your indulgence, our attorney general, Roger Tellinghuisen, is the new man on the block—he was just elected last November. But he's very capable and I'm sure Tellinghuisen will be a household word in Washington as it already is in South Dakota.

Senator MELCHER. I thank the Senator. The prepared statement of Senator Wilson will be made part of the record.[1]

We'll hear first from Attorney General Humphrey.

STATEMENT OF HON. HUBERT H. HUMPHREY III, ATTORNEY GENERAL, STATE OF MINNESOTA

Mr. HUMPHREY. Mr. Chairman, Senator Melcher, and members of the committee, it's a great honor to be here and to present testimony. I must apologize, Attorney General Spaeth is not with us at this point; he had a prior commitment, and I hope will be joining us by the time that we conclude our remarks.

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[1] See. p. 90 for the prepared statement of Senator Wilson.

I appreciate the opportunity to speak before the committee, as every one of my colleagues does. I serve as chairman of the National Association of Attorneys General Rural Legal Issues Committee. We have formed a working group of our staff members as well as the attorneys general that have worked closely in a number of these areas, Mr. Chairman, and we appreciate the opportunity to come before you and visit directly about some of the concerns that we have with the FmHA, in particular, comments that were submitted regarding their proposed regulations, the over 100 pages of new regulations that you've been discussing this morning.

We've provided those comments to the committee as part of our formal statement, and we have also submitted the comments to the FmHA, as I indicated.[1]

Also, Mr. Chairman, you should know that regarding those comments, the attorneys general from Kansas, Kentucky, Nebraska, and South Dakota have also joined subsequent to their initial submission to the FmHA.

Mr. Chairman, the purpose of the FmHA, as I'm sure you are aware, is to assist farmers, particularly those unable to obtain credit elsewhere—and it's always been our concern to see that goal is met within the States. The need is particularly critical, of course, at this time of continued economic distress in rural America. FmHA is the Nation's second largest agricultural lender, holding over $24 billion worth of credit. And obviously any restriction on that credit seriously affects the Nation's farmers.

With regard to the proposed regulations, they dramatically change the FmHA from a lender of last resort to a lender that more closely parallels that of a commercial type bank. Many of these provisions are troublesome, and I and my colleagues would like to focus on approximately five points in particular.

These points include the new risk-assessment ratios, which we estimate could disqualify, as has been indicated earlier here, up to one-half of FmHA's current borrowers.

Secondly, the weakening of the county committee's role in the eligibility approval.

Third, the barriers to beginning and re-entering farmers.

And, fourth, the decreasing preference given to family farmers when selling inventory.

And, finally, restricting the availability of direct loans.

Mr. Chairman, I would like to comment specifically on that last point, the restriction of the availability of direct loans.

Restriction of these kinds of loans--there are several troublesome points that come to mind when we take a look at those new regulations. First of all, the new regulations call for a lien on all assets regardless of the amount of loan. We firmly believe that this is an overreaching requirement and that it thwarts the FmHA's purpose of enabling people to eventually obtain credit elsewhere. If FmHA takes up all the collateral completely, then the farmer is not going to be able to go to any other creditor to obtain credit because they are going to want some form of security also.

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[1] See p. 100 for a reprint of the comments to the FmHA.

Secondly, the new regulations provide that there shall be no operating loans for cash rent. This, frankly, violates both the spirit and the letter of the law. The statute does authorize loans for cash rent. The agency itself requires cash rent when it leases property, so it seems to be inconsistent with what their own operation is.

And, finally, with regard to operating loans for cash rent, it's a particular hardship for beginning and reentering farmers, the very farmers that the FmHA is supposed to be helping in particular.

The new regulations also provide for no operating loans if the farmer has previously had debt settlement with the FmHA. Here, again, these new regulations would penalize reentering farmers. After someone has gone through the process, is perhaps out of the system for awhile, has been able to put together the kind of program that would allow them to reenter, now, because of that previous problem which they have then cured, they are no longer allowed to then come to the one agency that should allow them to reenter. This is contrary to the spirit of Congress' expansion of debt settlement programs specifically in 1985.

In regard to debt settlement, we've been working on that issue with State and national FmHA officials since September, and this includes also the provisions for homestead and leaseback arrangements.

The serious problems in particular, Mr. Chairman, in my State include that there are 40 percent of the 15,000 FmHA borrowers who are delinquent in our State. Many of these recognize that they must leave farming. But in the situation with the debt settlement, FmHA will not compromise a debt prior to total liquidation with the borrower. This seems to go against just the basic idea of being able to obtain the best resources and at the same time alleviate the most difficult circumstances, because FmHA's position on this issue is, frankly, legally incorrect. There is not an absolute requirement of prior liquidation; there's a possibility, but it certainly is not an absolute requirement.

To make total liquidation an absolute necessity, as the rules would provide, merely forces the borrower to go into bankruptcy, which also places the FmHA in a much less desirable position with regard to recovering any of the amounts borrowed. It just doesn't seem to work in the marketplace the way it properly should. My staff would be happy to provide you with additional information on this.

Mr. Chairman, there is one final point that I would like to also bring up with regard to the FmHA. It is not necessarily in their regulations, but it does concern us very much. In a number of the States, there have been changes in debtor and creditor remedies. In particular, in Minnesota, there is mediation, in Iowa there is mediation, there is contemplation of that legislation now pending before the State legislature in Nebraska, I believe. And to this date FmHA does not participate; expressly in our State they do not participate in that process.

And so with regard to attempting to resolve these matters in a form that is less confrontive than either foreclosure or in other forms of credit remedies, they are an entity, a substantial lending entity, that stays outside of the process that would bring people to the table. We are very much concerned about that.

In conclusion, I would say, Mr. Chairman, that if Congress wants to change the FmHA's purpose, certainly that is your prerogative. But we do not believe that it is the FmHA's prerogative nor job to see that that purpose is changed. We believe strongly that if you read reasonably these regulations, that will be the effect; that in fact there will be substantial harm done and there will be an impossibility of a great number of individuals in getting the lending that they would otherwise be able to have from the FmHA.

Mr. Chairman, I would like now to introduce Bob Spire, who is the attorney general from Nebraska, who would like to comment on the risk-assessment ratio concern.

Senator MELCHER. Thank you, Skip. Senator Exon wanted to be here, Attorney General Spire. I know he's delayed, but please proceed, and when Senator Exon gets here he will have some comments to make.

STATEMENT OF HON. ROBERT SPIRE, ATTORNEY GENERAL, STATE OF NEBRASKA

Mr. SPIRE. Thank you very much, Mr. Chairman and Senators. I would second, of course, what Mr. Humphrey has just said, and in addressing the loan risk evaluation process of these proposed regulations, the basic point which I would want to make and which all of us from this group of attorneys general wants to make is the congressional mandate purpose; in other words, we respectfully suggest that these loan risk evaluation procedures put the Farmers Home Administration in the same category in terms of requirements as would be a typical commercial lender, and that the intention of Congress, subject of course to Congress's future will—but that the intention of Congress is that the FmHA will in effect be a lender of last resort, that it will not have the same requirements, the same processes, as would the typical commercial lender. That's really basic to what we are saying.

Now, specifically, with regard to the loan risk evaluation processes that are set out in these regulations themselves, by using the very language within the regulations, it is our conclusion that the process here would disqualify about 50 percent of current borrowers on the basis that they would not even be allowed to make an application for a loan. Specifically, let me say this in that regard, that the process sets up preapplication standards and sets up a point system. If you care to look, there's a simple little chart that's contained on page 1721 of these regulations that sets this out. It's a form of calculation. But in essence it takes various ratios, various concepts, into play, as would a commercial banker, and in our reading of this—and we have materials that we will submit to the committee which will support this—it's our conclusion that about 50 percent of the present borrowers simply would not be allowed to even apply for a loan under these regulations.

In addition, it is also our conclusion at the other end that about 17 percent of present borrowers would be overqualified, therefore would not be able to apply, would be required to seek credit elsewhere, and they are only given a 2-week period to get two refusals on that basis. Certainly in the State of Nebraska and other Midwestern States, the fact of life is that for someone to go out and get

credit from a commercial lender for farm purposes and get a full-blown substantive evaluation and a refusal—and two, in particular—would take a much longer time than that.

So in effect we take the 17 percent at that end, the 50 percent at the other end, and what we come down to is we feel that these new regulations would in effect only be serving about 33 percent of current borrowers.

I'm aware that Mr. Clark this morning stated that in the judgement of his staff only 18 percent of current borrowers would be unable to apply under this formula. We respectfully suggest—and we are submitting information to the committee to this effect—that that is an understatement, that it is closer to 50 percent.

But I would suggest to the committee that even if the 18 percent is correct, that would be an appalling and devastating factor in the State of Nebraska, on any basis.

Senator CONRAD. Mr. Chairman.

Senator MELCHER. The Senator from North Dakota.

Senator CONRAD. Mr. Chairman, if I might just intercede, we have a GAO study now that on a sampling basis shows clearly that the 50 percent is the correct number, so in fact the GAO's work would substantiate the work that you have done.

Mr. SPIRE. Thank you very much, Senator. Well, again, I'm very pleased to hear that because it does substantiate our staff work, but I'm not surprised, Senator, because we studied this very thoroughly.

I would conclude simply by saying this to the committee, that the farm interests of Nebraskans, my State, and the other States involved—we are not asking a favor in the sense that we are asking some special treatment beyond the intention of Congress. It is our representation to this committee that the intention of Congress is to continue the traditional intent of a lender of last resort to our farm interests, not to convert by administrative fiat a lender of last resort into just one more commercial lender.

So, what we are asking for is a substantial revision of these regulations to effect that congressional intent so that our good farm people may be served in what we think is the appropriate fashion and the intent of Congress.

Thank you very much.

Senator MELCHER. Attorney General Tellinghuisen.

STATEMENT OF HON. ROGER TELLINGHUISEN, ATTORNEY GENERAL, STATE OF SOUTH DAKOTA

Mr. TELLINGHUISEN. Thank you, Mr. Chairman. I've been asked to participate with this distinguished panel more from the perspective of offering some comments concerning the effect of these proposed regulations on a particular State that is, South Dakota. As the good Senator from South Dakota indicated, I am a new attorney general, and this area with the Farmers Home Administration is only one of the many areas that I, of course, have been forced to take a very serious look at in South Dakota. I have a prepared statement for the committee, and I would just ask that be submit-

ted, and I do not intend to bore you with a piece-by-piece reading of that testimony.[1]

I would just like to make a couple of very general comments, though.

Farmers Home Administration in South Dakota, not unlike many other States in the Nation, is the single largest nonprivate lender for our farmers. And these regulations, quite frankly, Senators, would place in serious jeopardy the already shaky status of the farmers in South Dakota.

In 1986 Farmers Home Administration made total loans of approximately $114 million. Almost 25 cents of every dollar that's borrowed by South Dakota farmers comes from Farmers Home Administration. The agency currently owns approximately 190 farms, totaling 155,000 acres in the State, through foreclosures and voluntary liquidations.

It's my understanding that Farmers Home Administration is involved proportionately in South Dakota agriculture more than in any other State in the Nation.

Under the present guidelines, an average South Dakota farmer can qualify for an FmHA loan—and this is critical, because Farmers Home is so vital to South Dakota. Under the new debt-asset ratio and creditworthiness guidelines included in the proposed regulations, the average farmer will not be able to get a loan. In fact, if the proposed regulations are adopted, as we've heard, the best guess is that approximately 50 percent of farmers nationwide will no longer qualify, and I believe that will hold true for South Dakota as well.

Thirty percent of the South Dakota farmers have debt-asset ratios which exceed 70 percent, indicating severe credit problems over the course of the next few years. And more than 22 percent of our farmers fall within the 41- to 70-percent range.

Unfortunately, and not uncharacteristic of other States, we have more and more farmers showing up in bankruptcy court in South Dakota every year. In 1986 farm bankruptcies rose to 564, which was an increase over 1985, which was 338.

In 1985, 65 percent of those farmers declaring chapter 11 bankruptcy listed Farmers Home Administration as their lender.

I would submit to this committee that if the lender of last resort is cut off for those remaining marginal farmers, the number of farm bankruptcies can be expected to rise. Even those borrowers that are not facing bankruptcy in our State are concerned. We have numerous agencies within the State that are trying to offer credit counseling to farmers, and they have noticed a dramatic increase over the last year in the number of contacts with those agencies.

I don't mean to sit here and paint an entirely gloomy picture for agriculture in South Dakota, because we do have high hopes; we are a resilient breed as not unlike many of our other Midwestern counterparts. But I would just offer to you that it's a very sensitive situation, and that in my view implementation of these proposed

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[1] See p. 151 for the prepared statement of Mr. Tellinghuisen.

regulations would not only seriously hamper, but in a lot of respects cripple the farm recovery in our State.

There's a couple of areas that I'd like to touch on that have not been mentioned by my distinguished colleagues. For example, the disaster payments provisions, which continue to require county-wide disasters. Now, this does not equitably protect the individual injured by hail, tornado, or drought who does not happen to be in a county-wide disaster.

We've also not touched upon the decision to do away with our appraisal regulations.

There are other concerns as well, which we have conveyed in our comment, and I would again strongly underscore our joint submission of those comments to you, and would strongly urge your consideration of those comments.

You know, it seems to me it may be reasonable to ask why FmHA shouldn't be tough in dealing with its farm borrowers, and the answer again seems to be a simple one. The FmHA is not just another commercial lender; it is by contrast a Federal agency which has for decades served new, reentry, and troubled farmers to the advantage of agriculture as a whole. And it's more important now than ever that the Farmers Home Administration effectively carry out its traditional function. It's no time to cut off loans to South Dakota farmers or any other farmers through novel and what I consider to be outrageous interpretations of congressional directives.

Thank you.

Senator CONRAD [presiding]. Thank you. Before I recognize the Attorney General from North Dakota, I am going to recognize Senator Exon for a statement.

STATEMENT OF HON. J. JAMES EXON, A U.S. SENATOR FROM NEBRASKA

Senator EXON. Mr. Chairman, thank you very much. I was inadvertently delayed this morning because of some developments back in Nebraska that maybe our attorney general doesn't even know about. A new Senator was appointed this morning, and I got tied up on the telephone. I meant to be here to introduce my friend and colleague, the distinguished attorney general from the State of Nebraska, Robert Spire.

Mr. Chairman, I also understand that you have accepted this morning a committee resolution saluting my friend and our colleague, Senator Zorinsky, and I congratulate the committee for taking such action. We are going to miss him sorely, not only as a friend but as an outstanding spokesman for agriculture. His leadership is going to be something that is going to be very difficult for us in the Senate to make up for. We will do the best we can.

I just want to welcome the distinguished former chairman of the Nebraska Bar Association, Attorney General Robert Spire. He is an outstandingly dedicated public servant, Mr. Chairman. I have known him and he has been a friend of mine for a long, long time, and I would hope that the testimony that he has just given will be listened to very carefully, and I will read it in the record as we go forward on these matters that I thank all of you for coming in this

morning and testifying on—vitally important to the agricultural sector of our great country.

So with that I just wanted to say that Robert Spire is not only a very talented individual, but I have been particularly proud of him over the years because he started from rather humble beginnings, and for most of his life, Mr. Chairman, has had two definite strikes against him that he has overcome with dedication and a great amount of talent. The only further thing I have to say is that from the standpoint of a man who is not only a lawyer but a Republican, with two strikes against, he's come a long way. [Laughter.]

And with those two handicaps that he has overcome, I couldn't recommend anyone any better to come before our committee. Thank you very much.

Senator CONRAD. Thank you, Senator. Next we will hear from the attorney general from North Dakota, Nicholas Spaeth. Before he starts, I just want to welcome him to the committee and also to recognize the role that the attorney general of the State of North Dakota played in bringing this matter to the committee's attention during our field hearing in North Dakota. It was the staff of the attorney general, through his good offices, that this matter was brought to our attention, and we want to thank him for that service.

Attorney General Spaeth.

STATEMENT OF HON. NICHOLAS J. SPAETH, ATTORNEY GENERAL, STATE OF NORTH DAKOTA

Mr. SPAETH. Thank you, Mr. Chairman. It is indeed a pleasure to be here, and I can't let the occasion escape without noting that 3 years ago the two of us—and, of course, we have a longstanding close personal friendship, as you know—would have said we'd be facing each other in this kind of situation, and it was publicly reported, both of us would have been committed—involuntarily.

I think the room should note that the Honorable Senator from North Dakota achieved one of the greatest political triumphs in the history of the State of North Dakota this last November, and it's a personal pleasure for me to be here under this situation because of our friendship and long and happy collaboration.

My comments today will highlight three of the areas of concern that we attorneys general share about the proposed FmHA regulations. They are the FmHA's treatment of acquired farm land, the potential for implementation of surplus commodity rules, and the infringement on the role of the FmHA county committees. In addition, I will touch on three other areas that are compelling, but will take less time with them. That's the incomprehensibility of many FmHA forms, which is no news to anybody who's been around Federal Government; the need for a more rational debt-settlement policy; and the cost to farmers of greater reliance on guaranteed loans.

First, with respect to acquired farm land. FmHA is not only a major lender to rural America, it's a major landholder. As of December 31, 1986, FmHA owned 5,011 farms, comprising over 1.5 million acres nationwide. It is a major landowner in each of the States represented by the attorneys general. In North Dakota it

holds 78,000 acres; in Iowa over 59,000 acres; in Missouri over 49,000 acres; and in South Dakota—Senator Daschle, you will be interested to know—over 110,000 acres. Only Missouri, where there is 162,000 acres, has FmHA acquired more farm land than in South Dakota. But this is simply an immense amount of land.

But it is only the tip of an iceberg. FmHA starts the foreclosure process by sending out something called a Notice of Intent to Take Adverse Action. In 1986 it sent out 62,000 of these notices; in 1987 there will be over 26,000 more. Last year over a third of the 62,000 borrowers that received these notices failed to respond to the notice, and, under normal procedures, that results in foreclosures. Most of the remaining farmers who do not respond will be unable to qualify for any loan servicing release.

Thus FmHA is about to open the floodgates on an immense amount of foreclosures, and will acquire tens of thousands of farms, in addition to the 5,011 it now owns.

We believe that Congress has expressed its intention as to whom FmHA should sell this acquired land to. In title 7 of the Code, section 1985(c), you said that FmHA will for a 3-year period after acquisition sell this farm land exclusively to family farmers. You again have expressed the same kind of preference in the Food Security Act of 1985—that's 7 U.S.C. section 1985(e). Despite this clear language, the proposed regulations will allow sales to the highest bidder, to anyone, after 1 year.

This sale of FmHA farm land must be considered in the overall context of the farm depression today. FmHA, the Farm Credit Services, and life insurance companies together own a land mass equivalent to Senator Leahy's entire State of Vermont—6 million acres. According to The Wall Street Journal, most land sales from FCS and from life insurance agencies are going to go to retirement age farmers who are increasing the size of their farms. About 38 percent are going to city investors who own the land but do not intend to farm it themselves.

As farms get bigger, rural States, particularly States like North and South Dakota, will lose farm families who shop at local stores, attend local schools, support the civic organizations, participate in local cooperatives, like the Rural Electric Cooperative. We can't afford to lose these people.

FmHA was created by Congress in the depths of the Depression to help family farmers enter farming and move from tenant farming to farm ownership. The proposed regulation allowing sale to the highest bidder after 1 year is both illegal and exceptionally bad public policy.

With respect to county committee discretion, virtually every county in rural America has an FmHA county supervisor who has an advisory committee of area farmers. This committee from the very beginning of FmHA has had sole and exclusive authority to determine which loan applicants were eligible for FmHA program loans. Eligibility, by the way, is not the same as loan approval, which is a financial decision made by the county supervisor. The eligibility decision instead consists of an assessment of the applicant's industry, character, adequacy of farm background, whether the farm would be a family farm, et cetera.

Just last year Congress required that two of the three members of this committee be democratically elected by local farmers. FmHA now proposes to administratively overturn favorable eligibility decisions by county committees. We object to this proposal as a matter of law and as a matter of policy.

Congress has said that only county committees can determine eligibility. Moreover, as a matter of public policy, area farmers are better able to determine qualifications for eligibility than FmHA employees.

In other areas, too, FmHA is seeking to restrict county committee discretion. For example, county committees have historically been able to independently determine whether an applicant has an adequate farm background to have a reasonable chance of success. The proposed regulation would instead impose a rigid requirement that the applicant have operated and managed a farm in 3 of the last 5 years. This would keep many qualified beginning farmers and reentry farmers from being found eligible.

We believe that it is very important to preserve county committee independence, and to preserve the exercise of their discretion without fear of being overruled by FmHA employees.

Surplus commodity rules. As discussed on pages 16 and 17 of the comments we filed with FmHA, and I think the committee has been supplied with a copy, we have grave problems with the propriety and legality of FmHA's attempt to cut the production of surplus commodities on the backs of FmHA borrowers.

Right now, Vance Clark has the regulatory authority to declare that crops responsible for two-thirds of North Dakota's crop income—wheat, corn, rye, barley, soybeans—and dairies which are responsible for one-fifth of our livestock income are in surplus. If he did so, every FmHA borrower, including guaranteed borrowers, would be limited to loans to finance future production at a level not higher than the lower of the last 5 years production, or 2 years production. This would create chaos in our farm sector.

We believe that FmHA has not been authorized to create its own program for control of surplus commodities. That belongs elsewhere in the farm bill.

We urge you to prevent FmHA from utilizing this purported authority.

The proposed regulations are only one part of the problem with FmHA. One big problem is the virtual incomprehensibility of the notices farmers receive when FmHA decides when it wants to shut down a farm. I have attached exhibits to my testimony to see if you can readily understand them yourselves, and I will submit them to you when I'm done. Nor surprisingly, over a third of the farmers who received these notices last year failed to respond within the requisite 30 days. I believe FmHA is fully capable of writing in plain English, and should be made to do so, especially when the future of tens of thousands of farmers depends on the farmers' ability to understand these forms.

Debt settlement. FmHA now requires farmers to fully liquidate or to sell out or to pay cash for the property's present market value before it will consider debt settlement or compromise.

Vance Clark recently wrote to a member of my staff, Sara Vogel, whom some of you met at the hearings, saying that this policy per-

haps should be changed. He said that maybe FmHA might change this letter later on this year. But later this year is too late for the 88,800 farmers who have received Notices of Intent to Take Adverse Action in 1986 and in 1987.

The time for a sensible debt settlement program is now. Congressman Dorgan has introduced a bill, H.R. 1050, that I believe would do much to help in this area, and I urge this committee's support for that legislation. If not that one, then another bill just like it should be seriously considered, and soon.

Insured loans versus guaranteed loans. Under present law, which is contained in section 1317(a) of the Food Security Act of 1985, FmHA lending is to gradually shift from insured loans to FmHA rates of interest, which are set by law at 1 percent over Federal cost of money, to guaranteed loans at private lenders' rates of interest. In 1986, for example, you authorized $2 billion for insured loans at FmHA rates. By 1988, however, only $1 billion would be from FmHA and $3 billion would be from private lenders. This has enormous financial implications for FmHA borrowers, because FmHA interest rates are usually much cheaper than private interest rates. For example, as of March 2, 1987, FmHA operating loan interest rates were 7.5 percent for the full rate, and 4.5 percent for limited resource borrowers, while banks in North Dakota were charging operating loan borrowers an average rate of 11.161 percent.

For farm ownership loans, FmHA charges 8.25 percent for full-rate loans and 5 percent for limited resource loans, whereas the Federal land bank in St. Paul's lowest fixed rate loan was 10.56 percent and its variable rate ranged from 10.3 percent to 13.25 percent.

FmHA borrowers are already in deep financial distress. Many will simply not be able to pay these private rates of interest. I urge you to reconsider the shift to increased use of guaranteed loans, and to instead allow more insured loans directly from FmHA.

Thank you for the opportunity to be here today. We appreciate your efforts on behalf of family farmers.

Senator MELCHER [presiding]. I want to thank all of you on behalf of the committee for being here.

Chip, your presence here has a special meaning to all of us on the committee. Your father's presence here in this committee chamber was like a sunny day. I think, however, if he were here today we'd see the other side of it—he would be erupting like a volcano at what is contemplated by these regulations.

I've sat in this committee for 10 years and before that 8 years in the House Agriculture Committee. Prior to that, before coming to Congress, I was on our local bank as a director. I can tell you that our concern in that bank at the time regarding dealing with Farmers Home Administration was to have cooperation. We worked back and forth. There were some loans that the bank couldn't handle because of the restrictions on a commercial bank. We would be able to work with the Farmers Home Administration to take over a loan under various sets of circumstances and work it out so that the borrower could come back into a good credit relationship. I want to tell you my particular interest in this as a bank director. I was practicing veterinary medicine, and all of those people were

my clients. I had direct interest in their being able to stay in business, first of all to pay off whatever they owed me, and secondly to continue to be my clients. I think that is a relationship which communities in rural America have to a commercial bank and to the Farmers Home Administration—we are all in the same boat together, we are all trying to make a living.

Regarding these proposed regulations, I am pleased that Chairman Leahy earlier got assurance from Mr. Clark that the regulations would be submitted to this committee for examination and for comments and suggestions. There isn't any question that the purpose of all of the law that I know concerning Farmers Home Administration is being abused by these regulations, if they were put into effect. To the extent that not only the intent of Congress is abused but also the statutes themselves are thwarted and ignored, I can assure you that the committee will take its responsibility very seriously. We are not writing law just for an exercise in futility; we are writing law because we think it is in the national interest. Specifically on Farmers Home Administration we find that these regulations are going exactly in the wrong way. Not only are they violating Federal law, they are violating the intent of Congress so well stated by this committee on several occasions in the past 2 years.

What is that intent? The intent is that Farmers Home Administration is a borrower of last resort and that Farmers Home Administration has the obligation to work with individual borrowers to restructure their loans. That apparently is not being done. This particularly offends me, because at a time when we know we are in a farm crisis—we find that this particular agency wants to defy our intent and do exactly the opposite of what we would have them do.

It is very late for regulations to be coming out this year. My intention will be to withhold regulations for this year because they would obviously throw everything into a turmoil and not only make it worse but make it chaos.

I would hope that other members of the committee would feel as strongly as I do on that matter.

Senator DASCHLE. Would the chairman yield on that for just a moment?

Senator MELCHER. Yes, I yield.

Senator DASCHLE. It's my understanding that the comment period ends next week on these regulations. I think it's important at some point that either the appropriate subcommittee or even the full committee send a clear message to the Administrator. And I would hope that, feeling as the chairman does, perhaps in the form of a letter or a resolution, this subcommittee would make that fact known to the Administrator so that can be taken into account.

Should that fail, I would hope that someone on this committee—and I would do it myself if the chairman himself chose not to do it personally—found a vehicle legislatively to stop it in its tracks if our comment isn't enough. But one way or the other, I think your point is very well taken, and certainly, under the circumstances, I can't think of a more ill-advised action for the Farmers Home Administration.

Senator MELCHER. Well, I listened intensely while Chairman Leahy was making his comments, and specifically, after making

those comments about the discrepancies and failures of the proposed regulations, questioned Mr. Clark whether he would submit them to this committee prior to any finalization of them. And Senator Leahy, I'm advised, does want all of us to sign a letter to Secretary Lyng, suggesting to the Secretary in rather strong terms that we will very much want to review the regulations prior to any finalization of them.

I think the pertinent point is that not only do the regulations defy what is the clear easily understood intentions of this committee, they also violate the law.

Now, the comments that you have made have touched on this at various points.

Do you have a clear summary of all of the inconsistencies with Federal law? Shall we take this joint statement, which was summarized by Attorney General Spaeth, to be that clear statement?

Mr. HUMPHREY. Mr. Chairman, that is our formal comment. They serve as the basis. We perhaps could further identify specifically those points where we believe the statutes are violated. The concern, Mr. Chairman, that I have—and I appreciate, and I know my colleagues appreciate, your strong statement—the facts are that if nothing else is done, I suspect there will be one or more attorneys general that will take legal action. But the answer to the problem is not to go to court. We have a crop season coming on us, Mother Nature doesn't wait for courts or anybody else, and that kind of trouble, while it may be rewarding to those of us in the profession, does not solve the problem. We do need to have the kind of action that you have talked about, that your colleagues here have talked about. I think that would be most helpful.

Even more important than that kind of holding in abeyance, what is most needed is what we heard yesterday from Secretary Lyng, who indicated to us as we met with him that he had no intention, and he understood the role of the FmHA to be of assistance and help to farmers that are reentering or cannot get lending from any other place. He understands just as you mentioned, Mr. Chairman, the relationship that has to be worked out with commercial banks.

We need to see the agency working affirmatively that way rather than just holding in abeyance these dangerous changes of attitude that seem to be showing up. While it's better than having them actually take action on these, what is most important at the beginning of a crop season is to have somebody there actually trying to help work out some of these things, or to help farmers understand that there are some circumstances in which no borrowing can exist.

And, Mr. Chairman, I just recommend to you this one further point that we made that I mentioned, the fact that it is very difficult for those of us who now have mediation systems in place to begin dealing with the restructuring of a farm if it's operable, or helping that farmer come to grips with the reality that they have to make a change, if that lender, a very important lender, is just sitting outside the whole system. It's very important they become an active participant in this process.

Senator MELCHER. Well, I'm afraid they are sitting outside the whole system, as you attorneys general have indicated. I know in

my own State of Montana the number of chapter 12 bankruptcies that are being filed are being filed mainly for one reason, and that is to bring the creditors, principally the Farm Credit System, and the Farmers Home Administration to the table so they can have a restructured loan.

Is that what is occurring in your States?

Mr. HUMPHREY. Mr. Chairman, that's what's happening in Minnesota, and what we are trying to do is say before you go into bankruptcy, before you have to take that drastic step you ought to be stepping up to the table to see if you can't avoid that, because that's beneficial to the FmHA certainly as well as it is for the farmer.

Mr. TELLINGHUISEN. Mr. Chairman, I would just point out that for South Dakota our legislature just adjourned last week. Necessarily we have all breathed somewhat of a sigh of relief, but nonetheless during the course of the legislative session mandatory mediation was introduced, it was defeated. During the course of the testimony concerning that legislation, it came out that there are different splinter groups throughout South Dakota that are attempting to offer assistance to troubled farmers in bringing them and their lenders together in an effort to work out some type of debt settlement or debt restructuring. However, we do not have a mandatory mediation at this time.

Senator MELCHER. Nebraska and North Dakota, to your knowledge are there more chapter 12 filings, or at least threatened filings?

Mr. SPIRE. There has been a significant increase in chapter 12 filings, Mr. Chairman, in Nebraska just within the past few weeks. We don't know how extensive that will be. My own feeling on the chapter 12 is this: it seems to me that the very enactment of chapter 12 sent a loud and clear message that some reasonable forms of restructuring, of reamortization, are needed to be examined, and, if necessary, examined through the chapter 12 process. And, again, I think that very message, Mr. Chairman, is a message that needs to be conveyed to the Farmers Home Administration and other governmental lenders—Farm Credit, too—to attempt, to let's work this out without waiting and sitting back and forcing the club of chapter 12.

Mr. SPAETH. I would only add, Mr. Chairman, that I am suffering under one of the handicaps mentioned earlier—I'm a lawyer. The only group that benefits as a whole from the bankruptcy process is lawyers, because they make money, they make legal fees that come off the top. I am speaking against my profession, but if we can avoid that and cause some sort of restructuring and some renegotiation without going through that, we are all going to be ahead.

Senator MELCHER. Well, I would like to see chapter 12 or any bankruptcy proceedings avoided, but the fact is that we've an agency here holding what they say is close to $30 billion in farm loans, and I am sure that in my State they are not coming to the table to negotiate a restructured loan. I find that a little bit ridiculous because it is aggravating the situation.

If you can't restructure those loans, you are going to have to capitalize the interest payments. So the debt is bigger. You are going to hold off on operating loans, and when the feed needs to be paid

for so the cows have something to eat so they can have calves this spring, they don't have it. So they don't have as many calves and there's not as big a weight. As a result you've lost more money. When it comes to the time of planting in the fields, whether it's wheat, barley, corn, or whatever if you don't put it in or delay putting it in, then you are going to lose some more money.

So, all in all, who loses? The very people we want to help right now: the farmers and ranchers themselves, and the whole communities of which they are part—rural America.

So it seems to me that we are at a situation where if we hadn't enacted the provisions that permit a chapter 12, that we are just waiting for more of this delay in restructuring loans. I think the biggest financial club I have ever seen in my experience is the prospect of a chapter 12, because under that not only are you going to pay the attorneys whatever their fees are, but also the Farmers Home Administration is going to be left with nothing, absolutely nothing.

I don't think the $30 billion in paper that Farmers Home is carrying is worth very much at all. I think that's just the facts. We might as well face facts. The point is that in order to even salvage part of that $30 billion, those loans have to be restructured in order to save some operators that are very good operators. They have to have further credit. Our towns and all of our cities—we have nothing in our State that's very big—really have to have this land come back into production with these producers on it so the towns and cities can have a chance to live, too.

I've taken up enough time, and I'm now going to yield to the Senator from North Dakota and ask him to take the chair here to continue this hearing.

Senator CONRAD [presiding]. Well, I, too, want to add my voice of thanks to the four attorneys general of the States that have been here this morning. I think it's very clear from your testimony and from the testimony of Vance Clark that FmHA is operating outside the bounds of congressional intent. It seems very, very clear to me that the intent of Congress was to restructure loans, the intent of Congress is that FmHA be the lender of last resort. It is also abundantly clear that that is not what FmHA is doing; it is certainly not the thrust of the proposed regulations, as your testimony has made so clear.

Let me just brag a moment on our attorney general, because we are very fortunate to have somebody of his quality in elective office in our State, a Rhodes scholar, somebody who has been a clerk in the U.S. Supreme Court, somebody who would be the first one I would turn to if I were in trouble—and that's precisely how our State finds itself—we are in trouble, and thank goodness we've got an attorney general of this capacity and ability.

I was very interested, Attorney General Spaeth, in your comments on the illegality of what is being proposed, and I understand that there is in your summary—and I've read a good part of the package that the four of you have signed, and I think it's an excellent document, it's an outright condemnation of what FmHA is proposing. Do we have an actual laundry list of violations of law or of parts of the regulations that contravene the Code?

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Mr. SPAETH. Yes, I think you do, Senator. I think we've done a pretty good job of cataloging them in the comments that we filed with FmHA. I have some shorter testimony that had some references, too, that we are going to file, and what we would like to do when we leave here is perhaps file some additional written comments, basically addressed to the concern that you raised, where they are actually violating the law, because, as we all understand, that gives the committee a much better basis for going to FmHA and asking the agency to modify its regulations.

Senator CONRAD. We'd be very interested in having that, because, as you know—and please be assured that we are going to have another round with Mr. Clark; I mean, the whole idea here is that we gave him a chance to present his side of the story; now we are gathering the evidence and the documentation for the next session with Mr. Clark; the chairman has indicated we are going to have that session in the very near future, and we are going to be able to take to him what you've provided to us.

So you are laying the groundwork for us and we want to thank you for that.

Senator from South Dakota.

Senator DASCHLE. Thank you, Mr. Chairman, I was just noticing what a dangerous position the Senate is now in with you as chairman and me as the ranking member. [Laughter.]

I ask unanimous consent to rewrite the entire farm bill.

Senator CONRAD. Without objection, so ordered. [Laughter.]

Senator DASCHLE. They are going to have to take a little more consideration as they leave us in charge of the entire Senate Agriculture Committee.

But I want to commend our panel as well. You are probably as close to the fire on a daily basis as any public official in the State, and the four of you have done a remarkable job in confronting the issue and providing us with an insight that we simply didn't have prior to the time that you are here. And for that I am very grateful.

Let me ask—if we can assume for a moment that these regulations can be blocked, that ultimately the Farmers Home will concede to relinquishing their determination at this point to implement them, we are still faced with the question of availability, of loan availability. If you could, could you give me your best estimate as to how short, the shortfall of direct loan availability that you expect your State will experience.

Roger?

Mr. TELLINGHUISEN. Senator, I don't have that information for you. I would be happy to try and obtain that and submit an additional written comment.

Senator DASCHLE. Well, the reason I ask—and perhaps each of you can do that rather than try to provide us with a guess—is that we will be given an opportunity in the supplemental appropriations bill to perhaps alter the loan availability—may or may not, I should say—but should the opportunity exist, I think we need to act as forthrightly and as expeditiously as we can in that regard to ensure that that loan availability exists. I had farmers this last weekend in South Dakota tell me that they have never missed a payment, they are borrowers and in absolutely good stead with the

Farmers Home Administration, that are now being told that they are on a waiting list of 35 to 40 farmers in their county. In some cases these good borrowers are 25 to 30, ranking way down at the end, with no prospect whatsoever of loan availability this year, and, frankly, don't believe there is any other route. I was interested in the testimony earlier—I should have perhaps pursued it more aggressively—that through subordination or through PIK payments or through something else these farmers are going to make do. But that isn't what I hear. What I hear is that there is going to be a very traumatic understanding of their problem very shortly, and in many cases there isn't any forbearance on the part of the supervisor; these guys would rather face Hulk Hogan than go into their supervisors and address this problem, because they are not getting any kind of understanding. And that's a mentality I think that has been created at the State office—in South Dakota anyway—and certainly at the Federal office.

But if you could address that with any additional comments, I'd be grateful.

Mr. HUMPHREY. Mr. Chairman and Senator, you raised the word "forbearance." The problem with forbearance is that it is implied ad hoc; there are no real standards, it is done in some cases, it isn't done in others. This is something that we have talked about in other circumstances where we believe that there at least ought to be some standards set out and some procedures.

So you raise some very valid points. I, too, would like to get those specific statistics to you, and we will do that as soon as possible. But it definitely is a very serious problem.

Mr. SPIRE. If I may, Mr. Chairman, Senator, I would just reemphasize what General Humphrey just said. It's important to have the standards. Our people feel very much adrift, and, as a result, you are going on a case-by-case basis, and it's absolutely a chaotic situation. I think it's very important that there be--of course, obviously, fair standards that will reflect the discussions we've had. But definite standards and that the supervisors and all know what those are.

Senator DASCHLE. Let me ask, if I could, one last question. Attorney General Tellinghuisen, more graphically than anything else he could have said, stated the seriousness of the situation by reporting that in South Dakota alone last year we had 564 bankruptcies among farmers, which compared to 338 in 1985. I wouldn't ask him what it was in perhaps 1975, but, if I had to guess, we are talking of perhaps a fivefold or sixfold increase over what they had in that period of time.

That rash of bankruptcies is probably the greatest indictment of the whole Farm Credit System that we have right now. But it also raises an interesting problem that we really need to monitor from time to time, and that is the viability of both chapter 11 and 12, and whether or not they are working as we intended them to work.

Now, less than 6 months ago chapter 12 was passed. We've had the opportunity now to view it as a tool for a period of time.

What marks would you give it? Is it too big a club? Is it a practical tool? Would you advocate changing chapter 12 in some way in the near future? From your experience thus far, what advice would you give us?

Mr. SPAETH. If I might comment briefly, I think the jury is still out on chapter 12. First of all, there's always a lag effect. When Congress enacts a new law, it takes awhile for the practicing bar, for the community, to get used to the concept, to learn it well enough to begin to utilize. So we are just beginning to see filings under it. We are not seeing many resolutions yet because of the lag.

And so I don't think we really know how chapter 12 is going to work. I'm glad Congress did it.

But I would reiterate that for the vast majority of farmers who entered into chapter 11 before, and now chapter 12, the prospects of them working their way out of it are pretty slim. There's a tremendous administrative expense always involved when you go through a bankruptcy process—attorneys' fees, accountants' fees, things like that—which create a drain that you can't recover. And to the extent that we can find alternatives to bankruptcy, such as Minnesota is employing in their mediation process, or North Dakota with its credit review process, we are going to be far better off because the administrative costs are so much lower. We know the lender is going to take a hit anyway, because the loan generally exceeds the value of the underlying security, and we've got to start looking at those kinds of ways, because they are cheaper and they are faster.

Senator CONRAD. If I might just intercede. We are now at 12:10, and we have two more panels; and we need to complete the work of the committee by about 1 o'clock. So if the Senator would be willing to suspend, I would appreciate that.

Mr. Humphrey.

Mr. HUMPHREY. Mr. Chairman, if I might just followup one second, just to give you the example of how it can be effective. In less than 1 year, since the mediation program in Minnesota was started, we've had over 3,500 debtor requests: the lender proceeds with their foreclosure proceedings or redemption, whatever; the debtor requests mediation. Out of the 3,500, we have had, both in and out of formal mediation over 2,000 agreements reached, which means that there are 2,000 farmers and lenders operating, receiving income, staying on farms. There are ways that can be worked short of the bankruptcy. I think you need Chapter 12–again, we don't have those statistics either–we need Chapter 12, but we also probably need more effective and efficient ways to allow that transition to occur, to allow the restructuring to occur.

The problem is you either have nothing, or only parts of the process helping and working ad hoc, or you have chapter 12. I think that's too few tools; I really think there ought to be something more comprehensive than that.

Senator CONRAD. Thank you for that, and we thank the four attorneys general for their testimony here today. It was excellent. It helps us very much with the work of the committee, and we appreciate the effort that went into it.

Thank you very much.

Our next panel will be Eugene Severens, Center for Rural Affairs in Nebraska; Jim Massey, the Farmers' Legal Action in St. Paul, Minnesota; and Alan Bergman, the president of the North

Dakota Farmers' Union. Also joining this panel will be Karl Limvere from the North Dakota Farmers' Union.

Well, I'm sorry that we've been delayed. As you know, we've had a series of events here outside of our control which affected the hearing this morning, most notably the passing away of our colleague, Senator Zorinsky of Nebraska.

But let me assure you that what is said here today by the four of you will go into the record, and for the staff who are present—it is most important that they are familiar with what you say, because we are going to have, as has been indicated by the chairman, another opportunity with Mr. Clark.

So let's start with Mr. Severens, and if you could summarize your testimony, then we'll proceed with Mr. Massey and Mr. Bergman. We will allow your full remarks into the printed record, which is critical for us for our next round with Mr. Clark.

Mr. Severens.

STATEMENT OF EUGENE SEVERENS, STAFF ATTORNEY, CENTER FOR RURAL AFFAIRS, WALTHILL, NE

Mr. SEVERENS. Thank you very much, Senator Conrad. My name is Eugene Severens. I'm here representing the Center for Rural Affairs of Walthill, Nebraska.[1]

Mr. Conrad, before I begin my testimony, I might just give you some statistics that were discussed by the previous panel, I think you all might be interested in. We did an analysis of the rate of bankruptcies in the six Upper Midwestern States, and found a very interesting correlation between the rate of bankruptcy in those six States and the availability of mediation.

First of all—and we did this compilation as of February 17—Nebraska had the highest rate of bankruptcies with 132. However, the real meaningful statistic is to translate those bankruptcies into bankruptcies per farmer, so what we came up with is a ratio of bankruptcies per farmer. The six States are North Dakota, South Dakota, Nebraska, Kansas, Iowa, and Minnesota. The State with the highest ratio is South Dakota with 3.2 bankruptcies—these are all chapter 12 bankruptcies per thousand farmers; the second is Nebraska with 2.8. At the very bottom of the list is Minnesota and Iowa. I don't have the full report with me; I do recall that Iowa's rate is 0.56 bankruptcies per thousand farmers. The difference between South Dakota and Nebraska, on the one hand, which are the leading two States, and Minnesota and Iowa, the bottom two States, is quite significant—it's a difference of five bankruptcies per thousand.

And I will note, Senator, just because this is perhaps the important lesson—it's a possibility it's a coincidence, but I doubt it—Minnesota and Iowa are the two States with mandatory mediation; South Dakota and Nebraska are known as States with somewhat harsh debt collection laws. The two States, Kansas and North Dakota, had rates right in the middle of the other four States, and, interestingly enough, those two States have voluntary mediation.

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[1] See p. 119 for the prepared statement of Mr. Severens.

I thought the statistics were interesting and might be of value to the committee. I could make the full report available—I didn't bring it with me. I am recalling the statistics from memory, but I'm pretty sure they are fairly accurate.

Senator CONRAD. I think the committee would be interested in having those statistics available, if you could provide them.

Mr. SEVERENS. I'd be happy to.

[The material from the Center for Rural Affairs follows:]

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REBUILDING FAMILY FARM AGRICULTURE
INFORMATION ALERT NO. 87-06

July 27, 1987

MANDATORY MEDIATION IS ALTERNATIVE TO BANKRUPTCY

Summary: Chapter 12 bankruptcy is proving to be a popular method for farmers to give lenders their due while allowing farm families to retain a minimum farming base from which to rebuild their operations. Importantly for family farm based economies, Chapter 12 is preventing the arbitrary dispersal of the assets of a farm businesses and the unnecessary dislocation of farm families. In South Dakota, nearly 1% of all farmers have filed Chapter 12 bankruptcies in the first 6 months of the law's availability.

However, there are very large and significant differences in total Chapter 12 filings among distressed farm states. In a six-state study which examined bankruptcy filings per 1000 farms, states with no mandatory mediation (Nebraska and South Dakota) experienced a rate of Chapter 12's that is nearly 4½ times higher than states which have adopted mandatory mediation (Iowa and Minnesota). Statistics so far demonstrate that mandatory mediation is a viable alternative to bankruptcy (see chart), and some lenders are now actively supporting mandatory mediation.

Mandatory mediation before an impartial mediator is being used by farmers as an alterative to bankruptcy according to statistics collected by the Center for Rural Affairs over the last five months in six upper midwestern states. The chart below shows a consistent and repeated pattern: on a per farmer basis states with mandatory mediation experience far fewer Chapter 12 bankruptcy filings than states without mandatory mediation. States with voluntary mediation fall in between.

State	No. of farmers	No. of Chap 12 filings	No. of filings per 1000 farmers	Type of mediation
S. Dak.	36,500	349* (194)**	9.6* (5.3)**	None
Nebr.	59,000	446 (239)	7.6 (4.1)	None
N. Dak.	34,000	90 (46)	2.6 (1.4)	Voluntary
Kansas	72,000	188 (78)	2.6 (1.1)	Voluntary
Iowa	111,000	280 (173)	2.5 (1.6)	Mandatory
Minn.	96,000	114 (58)	1.2 (0.6)	Mandatory

* As of July 9, 1987. ** As of March 25, 1987.

When the March 25th figures were compiled, one interpretation was that mandatory mediation may simply delay rather than prevent bankruptcy filings,

and that the rate in mediation states would eventually catch up with states like Nebraska and South Dakota which have high rates of Chapter 12 filings and have no mediation. However, no such "catch up" has taken place.

On the contrary, the large discrepancies in Chapter 12 filings have continued. For example, in Iowa and Nebraska (two states with similar degrees of farm di tress) the discrepancy is increasing. In March, Nebraska's Chapte 12 filing (per 1000 farmers) was 2½ times higher than Iowa's (4.1 vs 1.6). In July, it was over 3 times higher (7.6 vs 2.5). The track record of mandatory mediation has won over important converts among agricultural lenders. The Omaha Farm Credit Bank, which originally opposed the adoption of mandatory mediation in Iowa, now supports it and testified in favor of mandatory mediation before the Nebraska legislature.

While mandatory mediation has a significant correlation to the number of Chapter 12 filings in these six states, it is not the only factor. The four states which provide some form of mediation (Kansas, North Dakota, Iowa and Minnesota) have also passed other laws providing alternatives to foreclosure. This makes it easier for farmers to resolve their debt problems and avoid bankruptcy. The South Dakota legislature rejected a mediation scheme at its last legislative session; now nearly 1% of farmers in that state have filed for Chapter 12 over the last six months. In Nebraska, a legislative committee favorably reported a mediation bill, but it has not been acted upon by the full legislature.

Mediation advocates point to a number of advantages that mandatory mediation has over Chapter 12. These include the fact that the mediation process is a face-to-face informal negotiation that is less hostile and more conducive to a consideration of more appropriate and personalized approaches to debt resolutions. Mediation is proving to be less expensive since, if successful, it avoids the high attorneys fees associated with bankruptcy, or for that matter, debt collection under state laws. Disadvantages include the possibility that farmers will go into mediation with inadequate preparation allowing lender representatives to dominate the mediation proceedings.

"Mandatory mediation" is mandatory only in the sense that the parties must meet before the impartial mediator and try to resolve differences. The mediator is a facilitator and cannot make binding decisions. If the parties fail to reach agreement, then they may resort to their normal legal remedies. Ordinarily, that means the lender can begin taking foreclosure and other debt collection actions, and the borrower can file bankruptcy or take any appropriate protective actions allowed under state law. <>

Mr. SEVERENS. Mr. Chairman, there are two stages to the current farm crisis. First, the liquidation stage, when excess debt that simply cannot be paid, must be absorbed. The second stage is the rebuilding stage. Once the excess debt and capital has been wrung out of the system, the economic situation, especially low land prices, will be favorably positioned for rebuilding.

The farm economy is now poised at the close of the liquidation stage and at the beginning of the rebuilding stage; it's a critical juncture.

If the major policy question of the first stage has been how will this excess debt be absorbed fairly, the major policy question of the second, rebuilding stage is will family farmers be in a position to take advantage of low land prices to rebuild their farms and restore an efficient family farm agriculture.

These are historic times for Federal agricultural credit policies and for the agency, FmHA, delegated with the primary responsibility for implementing these Federal programs. FmHA already has considerable authority to help FmHA farmers, first, reposition themselves during the liquidation stage, and, second, provide critical opportunities in financing during the coming rebuilding stage.

Unfortunately, both these types of authorities are being intentionally avoided. First, as others here are testifying, FmHA is doing little, if anything, to help family farm borrowers reposition themselves short of driving them to Chapter 12 bankruptcy. FmHA has the authority to work out fair and realistic debt settlements that could avoid expensive bankruptcy, or the unnecessary excesses of foreclosure, but in most cases it refuses.

We talk about this, Mr. Chairman, in more detail in our February 13 comment on FmHA's proposed regulations. I believe the committee already has access to that comment, but I would just like to read one summarizing statement from our comment in the first paragraph. "We view these proposed changes as general abdication of responsibility for administering long-standing bipartisan public policies. The overall impact of these proposed regulations would be to render the agency redundant by cutting out the very borrowers the agency was intended to serve."

Second, FmHA has the authority to become a principal agent in rebuilding family farms by targeting the distribution of its growing inventory of farm land to rebuilding and beginning family farm operations. The law clearly intended this result, but unfortunately the evidence suggests that FmHA is intentionally bypassing this policy goal. Part of the evidence is contained in a somewhat obscure change in the proposed regulations that Attorney General Spaeth referred to in his comments.

I think it's also worth mentioning, because it's important to Congress and it's important to taxpayers in general that targeting the sale and making FmHA's inventory available to family farmers and FmHA-eligible family farmers will not cost the Government any money. This does not require an appropriation for an FO loan to sell this inventory land; the capital is already there, the Federal investment is already there in the land itself.

Senator, how FmHA sells its inventory farm land is a critical issue, and I fear we are on the verge of seeing a major public policy thwarted. Our organization has prepared a special preliminary

report on this matter which is attached to this testimony. In the remaining time, if I may, I'd like to go through some of the report's principal points.

The report, which, as I mentioned, is attached, is a preliminary report. We intend to follow it up with more analysis and more evidence. We stepped it up a little bit to make it available to the committee at this point in time.

I would just like to read from the summary section that appears on page 1 of the report.

Recent FmHA data and interviews which we have conducted with selected state and local FmHA officials show that a disproportionate amount of FmHA's inventory farm land has been found "unsuitable" for program purposes and thereby classified as "surplus" by FmHA officials. This means that this land will not be held in reserve as suitable property for priority sale to FmHA-eligible family-size borrowers, as required by laws governing the sale of FmHA inventory farm land. Instead, this surplus farm land is now being sold on the open market to the highest bidder with discounts provided for cash buyers. By FmHA's most recent data, 78 percent of current farm land inventory sales (100 percent in some important farm States) is being sold right now to buyers who are ineligible for FmHA loans and therefore outside the scope of the agency's mission. If this were to continue, and given projections for a doubling of FmHA's inventory, the sale of around 7,000 farms, or over 2 billion acres, would bypass the congressional scheme which envisions this inventory as an important public resource for rebuilding an efficient family farm agriculture.

I would like to just skip to one of the charts in my testimony—it appears on the third page, chart 1, which is a percentage of the suitable land in the top 20 States with inventory. This is a ranking of the 20 States with the most land in their inventory, beginning with Missouri at the top and Arkansas at the bottom. The important item in this chart, I think, Senator, is the third column in each set, percent of land classed as suitable. You will notice that in your own State, North Dakota, 97 percent of the land is classed as suitable. That's very commendable and seems consistent with some of the remarks made earlier about the quality of FmHA administration in North Dakota. However, on the other hand, you look at the 16th State with the most inventory, Georgia, only 19 percent of the land has been classed as suitable. That means 81 percent of the inventory land in Georgia will not be made available to FmHA-eligible farmers on a priority basis. The rankings of these States are all up and down the chart. There appears to be little rationale for some of the wide discrepancies from one State to another. I think this chart shows that FmHA State offices are receiving no direction from the national office and are simply going their own way. Where you have a State with conscientious State offices, you see high percentages, like those in North Dakota, which represents a fairly close following of the law.

I think some of the real significance in our little study here—and this might actually contradict something that Attorney General Spaeth was saying—is found on chart 2, which is the percent of the inventory land sold to eligible borrowers. This is the first data available, for the first quarter of fiscal year 1987, showing how many farms are being sold and who is buying those farms. The record of this chart shows a considerable difference from even the classification which chart 1 shows. You know, the process is how these farms get classified in the beginning, but the next step is how are they actually sold.

And we suspect—in fact, we can document, Senator—that much of this land is being reclassified, after it's once been classified as suitable—it's being reclassified as surplus just before it goes on the market as a way to bypass the intent of the 1985 law to make this land available at a first-crack basis to FmHA-eligible borrowers. You note from that data on chart 2 that on a national basis only 29 percent of the sales made for the first 3 months in fiscal year 1987 went to eligible FmHA borrowers; the rest, 71 percent, all went to ineligible borrowers, many of those sold at a discount for cash.

Many of the other points in this report echo those——

Senator CONRAD. If you might permit a question at that point, who is the land going to?

Mr. SEVERENS. Well, we don't know exactly; all we know is that it's cash buyers and otherwise ineligible buyers. We don't know—in many cases it may be well-established family farmers in the community. That will be some that Farmers Home will point to as proof that they are implementing the law. But that is simply not the case. The law is very clear, that this land is not to be made available for established family farmers—that's not the purpose of Farmers Home. The purpose of Farmers Home is to make the land available to farmers who otherwise would not be able to get credit, and they must be FmHA-eligible, as we read the law.

So that I would suspect, without having much more than data from about six or seven sales made in Nebraska—one sale was made to a businessman, the other sales were made to farmers in the community. A couple of sales, very interestingly—and, by the way, these bids on the land sold in Nebraska—and I think Nebraska is perhaps being used as a Trojan horse in the Midwest for the sale of this surplus land—were themselves Farmers Home borrowers, and they had the good sense, when they submitted their bid, to write on the application that this bid assumes FmHA eligibility at the limited resource rate. Now, those are clever farmers who think enough to do that. The fact is they are having to bid against buyers who, if they offer cash, will be given a discount for offering cash, and it's contrary to the legislative scheme, which says that FmHA-eligible borrowers should get first crack at the land, that it should be classed as suitable for 3 years, and, if there is no FmHA-eligible borrower who buys the land during 3 years, then and only then will it be classed as surplus.

Mr. Spaeth in his testimony suggested—and I completely agree with him—that the proposed regulations that are the subject of this hearing are illegal when they attempt to shorten that statutory 3 years to 1 year by a mere regulation. It's elementary that regulations cannot change statutes so blatantly.

But it's even worse than Mr. Spaeth suggested, because in Nebraska they found a way not even to wait 1 year; they don't even wait one day. As soon as the moratorium on land sales was lifted in Nebraska, all of the lands that went up for sale were immediately classed as surplus and sold on the open market to cash buyers.

To the question of what possible authority they could have for doing this, they cited an obscure regulation and gave the very weak argument that this land was unsuitable because it didn't have a house or because it didn't have buildings.

Now, Farmers Home has always made FO loans for bare ground. They are concerned that a farmer have decent housing and adequate buildings for the proposed operation, but they are taking this standard that's meant to be dealt with on an individual basis and generically classifying all land that does not have suitable housing or buildings as therefore unsuitable for sale to a Farmers Home borrower, completely neglecting the fact that the way farms are built up—at least in the Midwest and I think over the country—is that you buy a 40 here, you buy an 80 down the road, you work your way up; that's the safe conservative way to build up a farm; you don't instantly buy a farm with a picket fence and a dog on it. I mean, that seems to be what the State office in Nebraska is pretending to do: if we don't have a house and the buildings, we are not going to make it available and reserve it; we are going to class it as surplus and get rid of it.

Senator, I've perhaps taken more of my time—and I know you have a time limit. I would like to make one last point that I think picks up on something Senator Daschle and Senator Melcher were alluding to, and that is, you know, what is the next step here. It struck me as I listened to the testimony that we have focused right now more talent in the form of State attorneys general and commissioners of agriculture on the statutory and regulatory framework of Farmers Home, than probably there ever has been in the history of the agency. The time is ripe to take advantage of that talent and seriously consider a rewrite of FmHA's basic authorization. I mean, we have been fiddling around the edges of FmHA's legislation for years, and I've been doing that myself in a somewhat frustrating way since 1978. I think the talent that is focused on this issue now needs to be taken advantage of; Farmers Home has more than demonstrated its flouting of congressional will. I would like to see this committee do more than simply protest the current regulations, and actually take the bull by the horns and consider some legislation. I would certainly, myself, personally be interested in volunteering our resources, minimal as they are, to such an effort, and I think maybe some of these attorney general offices represent a terrific resource base on which the committee could draw.

Thank you very much for your time.

Senator CONRAD. Thank you for that testimony, and thank you for that recommendation. My fear is—and I will just make this comment before we go next to Mr. Massey—we've got an agency that's a rogue elephant; frankly, they aren't paying any attention to the law, and it makes you wonder how much attention they would pay to a rewrite of the law.

We will go now to Mr. Massey, who is with Farmers' Legal Action in St. Paul, and, again, if you would summarize your testimony—I am sorry that we are running into this time constraint, but we will go as long as necessary to get the statements into the record. Again, your full written statement will go into the record, and then we will proceed to Mr. Bergman and have a chance for follow-up questions.

Mr. Massey.

STATEMENT OF JAMES T. MASSEY, FARMERS' LEGAL ACTION GROUP, INC., ST. PAUL, MN

Mr. MASSEY. Thank you, Mr. Chairman. My name is James Massey, I'm the executive director of the Farmers' Legal Action group in St. Paul, Minnesota. For the record, I have submitted formal testimony, along with a copy of the comment that we submitted on behalf of our clients to the Secretary with regard to these proposed regulations.[1]

I appreciate the invitation to appear and testify today. I appreciate the committee's invitation, and particularly the Senator's invitation, to have this opportunity to share some of our observations and concerns and, quite frankly, a sense of professional and at times personal outrage at what we have experienced with Farmers Home borrowers and Farmers Home policies and procedures in the field in the last couple of years.

Let me provide just a very brief background, if I may. Our organization is a separate corporate structure; it's nonprofit, formed last summer. But I've been working on these issues; in fact, my first experience with these issues took place in Bismarck in a cold November or December in 1982, when I met with Sara Vogel who was the attorney in the *Coleman* case and who passed it on to me, unfortunately, when she joined Attorney General Spaeth a couple of years ago.

Since that time I have filed several lawsuits on behalf of farmers; I am now lead counsel in the *Coleman* case in North Dakota. We have an appearance before Judge Van Sickle in about 2 weeks on these issues revisited. I have also filed a lawsuit in Minnesota challenging FmHA's implementation or, from our perspective, refusal to implement properly the county committee election process that was mandated in the 1985 farm bill. I think, having heard Mr. Clark's testimony today and having evaluated numerous other issues that we have been looking at for some months, it's safe to say that we will be involved in more litigation as the coming months progress, if something substantial does not change.

Our organization provides, in addition to litigation that we do—our principal focus nationally is on legal education and training of lawyers, farmers, and farm credit counselors and advocates. I was looking through the committee list, and in the past year my staff has provided such seminars or workshops in every State represented on this committee, with the exception of Chairman Leahy's State of Vermont. I've been to some of these States numerous times and I've worked with farm organizations, bar associations, law schools, church groups, legal services programs, and so on. We presented over 75 sessions during that period of time and have worked with upwards of 4,000 farmers and their attorneys.

I provide this background simply to say that I don't think any of the statements that have been made by the Senator himself, by any of the other witnesses, are at all hyperbolic or out of school with what we've observed.

I have been doing Federal litigation, public interest, and civil rights litigation for over 13 years, and I said in 1983 to our judge in

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[1] See p. 124 for the prepared statement of Mr. Massey.

Minnesota in a companion case to *Coleman* that I had never seen any group of persons whose lives depended upon or were controlled by the Government—having represented prison inmates, public housing tenants, welfare recipients, old people, young people, mental patients, and so on—any group that had fewer established legal rights and less enforcement of what rights they did enjoy than Farmers Home borrowers, and in particular farmers in general.

I think it's sad that in the 4 years that have passed since I made that statement that if anything, because of the aggressive, very aggressive stance of this agency in ignoring and undoing what this body has attempted to do legislatively and what we have attempted to do in the courts—I think we have seen a substantial regression of what those rights are.

Let me very specifically go to a couple of things—and, by the way, I wish Senator Leahy were still here, because as he was talking about the numbers of words in these documents, two things came to my mind. One is Second Timothy—and I believe it's chapter two and the sixth verse—which is inscribed ironically on the frieze around the top of the Department of Agriculture here, and which is also a key point of Judge Van Sickle's order in the first *Coleman* case 4 years ago, and that provision says that the laborer is worthy of his hire, or the farmer who produces the goods is entitled to the first share. I think we need to go back to that, those 6 words, and also couple them with the 10 or 12 words of the due process clause and trace a continuum that I outline in detail in my testimony of what Farmers Home has been doing since the early eighties and why these regulations are part of that continuum, and, although important, I think they are perhaps the trees that may make us lose sight of the forests. I join in Mr. Severens' testimony on that point: I think we ought not to lose sight of the fact that there are many more substantial problems than are reflected in these proposed regulations.

First, Farmers Home has, in disregard of Second Timothy, to the point it represents at least a code of civilized conduct, if not the law, that we, I think, respect in this country, and due process—Farmers Home has attempted repeatedly in the last 6 years to starve people off of their farms. I'm not speaking, I hope, hyperbolically; it's true, it's established, the judge recognized it: there have been repeated attempts to repeal regulations, change regulations, ignore the will of the Congress in an effort to simply not release from the farmers production sufficient money to live on.

Senator, you inquired—I believe it was you who inquired of Mr. Clark this morning whether or not the 1985 farm bill provision regarding release of living and operating expenses had been implemented by regulation, as he is required to do, or the Secretary is required to do—and either Mr. Clark has been ill-advised by his staff or doesn't understand what that means. What they have done, quite simply, is added three adjectives in their regulations—the words "crucial," "indispensable," and "basic" to the statutory requirement of "essential," and said that's the guideline. We have filed a new lawsuit on that point; we have asked the Government to put in specific guidelines for release of living and operating expenses, for things that they have denied repeatedly in the past, in-

cluding local property taxes, medical expenses, church offertories, and so on, and the Government has steadfastly refused to do that. That's a continuing point of contention in the litigation that will be before the judge, if it's not resolved before that.

Senator CONRAD. If I might just intercede there, because I was very intrigued by Mr. Clark's answer to me this morning on the question of the treatment of basic expenses. And what I'm hearing from you is that they have added to the test that Congress set out, which was essential, and they have made it a more rigorous test.

In your experience operating in a number of States, is there a consistent application of that requirement?

Mr. MASSEY. No.

Senator CONRAD. Even of their own regulation, is there a consistent application?

Mr. MASSEY. Absolutely not, and not only in terms of defining substantively what is or is not essential as an item, for example, feed or seed or medical expenses, but also in the manner in which it's done on the big picture. In one State, for example, a county supervisor will determine in July—and we have clients who have raised this very issue—that this farmer is going to be liquidated, therefore the planned expenses this farmer has for continuing the operation because he doesn't need them, because we are going to liquidate him. And if the guy down on Main Street, the veterinarian, for example, the seed and feed dealer, is standing in line expecting to get that payment from that operating expense, it's too bad, they are not going to get it. Farmers Home is first in line, always first in line, in their judgment, in a situation like that.

So we have not only disagreements between county supervisors in various parts of the country about what's essential, but, again, the question of during what period of time. I have an ongoing experience right now with one of your constituents, who has been denied releases of money to pay IRS employment taxes on hired labor that he incurred during the 1986 operating season. Now, it would be interesting to get the former tax commissioner perhaps, or the current tax commissioner, or people from IRS together with Farmers Home and let that one get duked out.

Senator CONRAD. That's essential. [Laughter.]

Mr. MASSEY. But the answer is absolutely not, there's no uniformity, and I take direct exception to Mr. Clark's statement that they have done that.

Moving quickly, the point has been made about the Administrative Procedure Act in notice and comment. What hasn't been said—and let me say this for the record—that 30 days from the standpoint of those of us in the field who deal with Farmers Home is a generous period of time relative to the typical experience. The agency has attempted to implement or gone through the motions of implementing half of the farm bill, 1985 farm bill, provisions through what they call interim regulations with no notice and comment period; they are published with a statement that it's not necessary or it's too much of an emergency; they take post facto, after the fact, comments, and in none of those cases have they republished what are truly final regulations. I specifically note the county committee regulations, the leaseback and homestead regula-

tions, and the living and operating expense regulations—all were implemented that way under the 1985 farm bill.

It's our judgment—we are litigating that issue in two cases—again, it's our judgment that it's illegal, and perhaps some help from this committee would straighten that out in the future.

As to a laundry list under the current regulations, of legal violations, I will join in what's been said here—and I think I count at least six, and I won't go through them again. But direct violations of Federal statutes that any of us can read—and you don't have to be real smart or real creative to get down to the library and pull out 7 United States Code and read what this body has written as far as 1 year versus 3 years, for example, the requirement that appraisal standards be published in the Federal Register, a requirement that the county committee be independent of the Secretary of Agriculture, and that appeals be had on adverse decisions. Those are just a few areas in which this agency has made a direct assault on the language, to say nothing of the intent, of that legislation.

We also join in the policy concerns expressed by the attorneys general, by Mr. Severens, again detailed in our comments, and I want to take the time to go through those individually.

I know I'm not here to debate Mr. Clark, but I'm sort of in that business—we are trained to do that.

Senator CONRAD. Oh, that's fine.

Mr. MASSEY. A couple of other comments that he made that I simply have to respond to. First, our reading of the proposed regulations—and I think everybody who's looked at them who has testified today has concluded that there is no appeal from the preapplication determination on those ratios. If he wants to write in an appeal specifically, that certainly would make us happy, but the——

Senator CONRAD. Let me just intercede at this point. I asked him directly and specifically if there was an appeal. He answered very directly and specifically that, yes, there was an appeal.

Are you saying here that that's not the case?

Mr. MASSEY. Well, I can't find it; it may be written in invisible ink or in code that we don't understand. We have not found it, and that was one of our principal concerns—in two respects. First, to not allow that to be appealed I think violates directly the 1985 farm bill provision that says adverse credit decisions of the agency personnel shall be appealable; and, secondly, I think it goes to the heart of the county committee question and robs the county committee of ever having the opportunity to have its input in who's going to be a borrower and who is not. If we have a rigid ratio analysis that's determined by the county supervisor and it's nonappealable, the threshold issue of eligibility will never necessarily be determined, as I read the regulations.

Senator CONRAD. Let me just flesh this out right here, because I want it clear on the record what it is that's being said. I inquired I think quite clearly whether or not there was an appeals process set out by FmHA. Mr. Clark assured me that in fact there was an appeals process. And what you are saying is that in fact there is no appeals process.

Could you specifically outline why there is no appeal available?

Mr. MASSEY. I don't have the regulations in front of me—I'm sorry, Senator. I believe there was a direct reference made to the nonappealability of the ratio determination. I can supply that reference to the committee after the hearing. I'm sorry I don't have my regulations or even my comments—I gave my last copy away before I got up to the table, unfortunately.

Let me say in general response to that, there is in the appeal section of the Farmers Home regulations a laundry list of things that the agency has designated nonappealable. The preratio analysis as to why they consider it, in our judgment, nonappealable is that they have this general category that's called anything that's concrete or statutory, in other words, about which there could be no dispute. Appraisals have always been determined or designated nonappealable, for example, which in our judgment is ludicrous, because anyone who's ever done any property work or condemnation cases or even gone to a bank to get a loan knows that there are appraisals and there are appraisals. And yet these things fall into a category that they've designated nonappealable. So I will respond specifically to that question, Senator, after the hearing, if I may.

Senator CONRAD. I'd appreciate that. I mean, if there was anything that was clear this morning, it was that there was a very clear question put to Mr. Clark on whether or not there was an appeals process on this matter. And he answered very definitely that there was. If that's not the case, it's going to be a very interesting conversation the next time he comes before the committee.

Mr. MASSEY. Thank you, Senator. And on that point also, on the living and operating expense release, from our client's perspective it's incredibly significant that that be clear in the record, because there are no guidelines, and that's the lifeblood of people who are not even getting any operating credit any more. The last shot they have is the calves they sell, the grain they produce, or the milk they milk. And when Farmers Home refuses to release that money, it's not only the operating expenses that are gone, it's the money to keep the lights on and to pay the heat bill.

Senator CONRAD. I think it will also be clear in the record that I asked Mr. Clark if in fact guidelines had been issued on that question, and he again asserted very clearly that, yes, guidelines had been issued. We have asked for those guidelines and we will be interested to receive them.

Mr. MASSEY. One other response he made—the question was posed as to whether or not the 1924-14 notice, why it did not include notice of other various options under the statutes, in addition to what it does contain, Mr. Clark indicated that those were options that were only available after liquidation and therefore there wasn't any reason to tell people of them early on. Our position—and I think it's joined in in at least some respects by the attorneys general in their comments—is that that is absolutely wrong under the statute. There is nothing in the legislation that says one must liquidate to get debt settlement, for example. The other provisions need not be implemented that way, and have been. And I would identify this for the committee as the next arena of litigation if the agency does not modify its position on these programs and recognize the realities of the marketplace.

Senator CONRAD. Again, if I might intercede, that interpretation that Mr. Clark gave, that those are post-liquidation remedies, defies logic and reason.

Mr. MASSEY. It also is contrary to his own regulations. His own regulations very clearly contemplate the possibility of debt settlement, for example, in some circumstances without complete liquidation. We have a letter from Mr. Clark from December, stating exactly what he stated before this committee today. What we have is a regulation that impermissibly narrows the statute, in our judgment, and a policy statement from the Administrator which quite clearly violates not only the legislative intent but his own regulations, even the new ones, which were published December 18 on the debt settlement program.

Finally, his response was that the county supervisor, in the normal course of business, tells people about these programs anyway. Let me relate the typical response when a borrower asks about the programs. First, county supervisors don't do that as a matter of course, because, as the county supervisor said today here, she joined in Mr. Clark's statement that we don't do debt settlement until after we liquidate, so there's no point in telling people about it. When our clients ask about it, in many cases what they are told is we don't have the authority to do that, or come and talk to us about it after liquidation or acceleration and maybe you can do something at that point. The forms, the application procedures for all of that business, and, as the Senator well knows, the Notice of Intent forms themselves, are completely incomprehensible. The reading level is post-graduate; it's more complex than the Harvard Law Review. Our experts have submitted testimony to the court saying that the average borrower of FmHA has a 10-year educational level and simply cannot be expected to understand what it is that is expected of them in these forms. And that accounts, as I think the Senator from South Dakota noted, perhaps or probably for the very high rate of nonreturn of these things, which is fatal in the appeals process. Once you don't pass "Go," you go directly to jail in the Farmers Home system and you don't get another chance because you have waived all of your appeals.

Finally, to wrap up, let me restate my comments on the Notice of Intent, as far as the 1985 farm bill, I think, goes to the heart of the middle part of this continuum that started when Secretary Block refused to implement the 1978 deferral statute, and we sued in 20 States and won every time, and finally they implemented that—when they got a hold of the 1985 farm bill, they excluded FmHA borrowers from county committee eligibility, they allowed a 5-day nomination period, over 2 days of which were over a weekend, for nominations for county committee positions; they didn't publish regulations for notice and comment on any of the programs I mentioned before. They have relegated the homestead and leaseback programs to, indeed, post-liquidation possibilities for people who have such bad relationships with Farmers Home at this point, often which end by the Farmers Home person saying to them: you'll never get another thing from this agency after we take the keys to the farm, and that's what we are going to do. And people are relegated with trying now to get these things back, when the language of the statute—and this is a Webster's explanation,

which, again, one doesn't have to be very smart to find—the language of the statute on the homestead provision says "retain," it doesn't say "give away," it doesn't say "liquidate," it doesn't say "lose." It says retain the home and adjacent acreage in the case of liquidation, bankruptcy, or foreclosure. The Farmers Home has turned that on its head, they've said to us directly: you give it all back to us, take your chances, and then apply for these things. And I have said to our State director, and I've said to Mr. Clark, if I did that I would call my malpractice insurance carrier first thing, and then I would go to the table and say, all right, we'll give you it all back and take our chances. It is simply not an ethical work arrangement for a lawyer to undertake, as far as I'm concerned, and a stupid one for a farmer to agree to, and an extremely unreasonable one for the Secretary of Agriculture to demand.

The living and operating expense problem, also in the 1985 act—I've mentioned the debt settlement provisions have been narrowed and constricted to be the post-liquidation procedures, also in violation of the intent of the act.

In conclusion, I'd like to join in Mr. Severens' recommendation that this committee and the Senate as a whole take a good hard look at this agency at this time. It is a turning point in the history of agriculture. This agency is needed now more than ever, and now more than ever has turned itself inward and set itself on a course that, from our clients' perspective, is directly contrary to the mission and historical purposes of the program.

We stand ready in my small organization to do what we can on behalf of our clients. Let me just add, we would appreciate, our clients would appreciate, whatever help we can get legislatively. There are more welfare attorneys in St. Paul, Minnesota, than there are good farm law attorneys in the entire country, and we simply cannot keep up with the machinery and the bodies and the horsepower that are contained in that Agriculture building across town here. They are moving very quickly, and the number of persons out there who can play the traditional balancing roles of lobbying or filing lawsuits on systemic issues that are done in every other area of Government, from environmental issues to women's rights to toxics to regulated industries in general, just don't exist in this sector. I think time is moving very quickly, and whatever attention can be brought by this committee to these issues in further oversight hearings and indeed in some new legislative vehicles I think will help to stave off what appears now to be grimly inevitable for many of our clients.

Thank you very much.

Senator CONRAD. Thank you, Mr. Massey. And now we will hear from Alan Bergman, the president of the North Dakota Farmers Union. I want to welcome Alan, and Karl Limvere as well, from the North Dakota Farmers Union here to the Senate Agriculture Committee. I appreciate very much your patience and your forbearance, but I want you to be assured that your complete statement will be entered into the record and will form the basis for our next session with Mr. Clark.

STATEMENT OF ALAN BERGMAN, PRESIDENT, NORTH DAKOTA FARMERS UNION, ACCOMPANIED BY KARL LIMVERE, ASSISTANT STATE SECRETARY, NORTH DAKOTA FARMERS UNION

Mr. BERGMAN. Thank you, Senator Conrad. I'm pleased to be here, and I'm pleased to see you sitting there in this committee in the chairmanship today.

I guess if there is one issue in my short tenure as being the new president of North Dakota Farmers Union that I've had the membership behind on, and with many calls, is this issue. It's our job to educate the members as to what is happening. When we did the research and filed the comments on the regulations that were proposed and made it known through the media and our publications, I got call after call after call saying, yes, you need to do something, you're right on. That's opposed to many other issues where we do not get the consensus of our membership. But this one, let me say it is.

I'll just say that our testimony parallels almost everything I've heard this morning with the exception of Mr. Clark. I would concur with the others at this table, with everything they've said. I'd like to bring to your attention, checking this week prior to coming here, that our state FmHA office is out of money. The direct operating funds were depleted February 20. We've already used the full funding of the first two quarters of $47 million. As of last Friday, it had $9.7 million of operating loans awaiting funds. We are at the peak of the season when operating loan applications come at a rate of about $1 million per day. And the third and fourth quarter funding of $15.9 million is running very short, even if that is going to be accelerated and made available soon.

I point this out because I also want you to look ahead. This morning Mr. Kirschenheiter said that the PIK certificates or the advance payments, what it amounts to, are helping many people get through this credit crisis. Well, next year, under the current law, we'll not have the advantage of having an advance payment. I can only say that this situation will be magnified through the credit institutions next year.

We believe that the guaranteed FmHA loans cannot substitute for direct loans, and the shift from direct to guaranteed loans must be reversed. We are deeply distressed by the phase-down of the direct loan program and by virtual phase-out of the farm ownership loan program, despite real need for assisting beginning farmers and some real opportunities for new farmers to get into business. The fact is that beginning farmers almost have a better chance of winning the Reader's Digest sweepstakes number than to wait for a farm ownership loan from FmHA.

Land values have come down, and they are at a point where we could cash-flow. The seventh district of Farm Credit Services is offering foreclosed and forfeited land at drastically reduced interest rates. But only those who have a substantial down payment are able to take advantage of these sales. This simply means that the already larger operator is getting low interest rates for expansion while the beginning and distressed farm family have no place to turn for financing and financing land purchases.

And may I say that I've had many and many a neighbor who says: Why is this happening to us? They have basically stood still during the inflated land values of the past decade, and now have found land that is being made available and they could buy it, yet there is no place for them to get capital to do it. I think that's wrong, I think that FmHA should be in that direct loan of farm ownership, and should continue that. They are not doing any of it.

The only way Farmers Home will make any real debt adjustments or restructuring is for the borrower to first totally liquidate his farm operation. With the current regulations very few farmers are willing to take the risk of liquidating in hopes that FmHA will refinance them.

Farmers Home seems to have the philosophy that in order to save the farmer, they must first destroy the operation. This Nation's economic and agricultural policies have created the massive deflation in commodity prices and agricultural assets. I think we therefore have a responsibility to the victims of that devaluation.

Farmers Home will suffer economic loss whether it sells the land now or sells it later after the write-down or going through a chapter 12. The write-down or a restructured loan does not require new appropriations or additional cost to the Government, and there is no new legislation that is needed for such write-down and debt adjustment. Rather than restructuring farmers, Farmers Home is pursuing a policy of restructuring American agriculture into larger and larger farm units without regard to the cost or the damages that such policy has on the communities or the infrastructures of rural America.

May I add that I believe this will only concentrate more and more of the land, concentrate more and more of the wealth, and eventually concentrate the production of food in this country, which is absolutely wrong.

Congress must mandate that the Farmers Home Administration return to its original objectives of assisting family farmers and keeping as many families as possible in agriculture. As part of that mandate, we believe that the latest set of proposed regulations must be immediately and permanently withdrawn.

It appears to us that the purpose of these regulations is to provide administrative mechanisms by which FmHA will increase its denial of loans. In fact, taken as a whole, these regulations are designed to phase down and phase out Farmers Home loans.

The proposed preapplication process, the loan risk evaluation index, the increased cash reserve requirement, the denial of cash rent option, increased security requirements, and a host of other restrictions established by these proposed regulations are what lawyers would call arbitrary and capricious. They erode the authority of the county committees while increasing the authority of the Farmers Home officials. They would leave Congress without a method of measuring the demand and the need for Farmers Home loan programs. They would deny loans to farmers who have undergone previous FmHA debt adjustment. Point after point, these regulations make Farmers Home more restrictive, more elusive, and more bureaucratic. Point after point, the flexibility of county offices and committees in loan assistance is curtailed.

I want to call your attention to the regulations that extend the surplus-crop rule to the guaranteed loans. This rule is a time bomb waiting to be dropped whenever the agency decides to commit suicide, because the guaranteed loans with the local bank would come under that same rule.

We urge Congress to not only investigate Farmers Home regulations, but also the process used in their regulatory games. We can only draw one conclusion from the regulations that have been proposed and implemented: USDA is trying to administratively regulate Farmers Home Administration out of business.

Because of the regulatory maze that has been created and the failures of Farmers Home Administration to respond to the credit needs of rural America, both our State and our national organization have called for the total reorganization of this agency. I would concur with the previous two people who testified here, that we would stand willing to help in that process, to outline what is needed in a new agency.

I just would like to say in closing that it may be totally easier to reorganize FmHA than for Congress to unwind that regulatory maze that USDA and FmHA administrators have created.

I guess I'd like to thank you for this opportunity to appear. We have a written filed statement, and included in that statement is our written comments on the proposed regulations.[1]

Let me say that we are novices at this; we do not have the capability or the legal expertise, as Mr. Massey even has, but we did comment with 17 pages to those 99 pages of regulation. It took a lot of time and a lot of effort on our part. But we did our best, and we think they are wrong and we need to have some changes immediately.

Senator CONRAD. Thank you very much, Mr. Bergman, and the rest of the panelists. I've been reading your statement, the 17 pages and the attachments. It's extremely well-done, I think, and will help us fill out the record.

Let me just ask Mr. Bergman, and then direct it to the others, the question of the effect on the State of North Dakota of these proposed regulations. If in fact we would have a 50-percent reduction in FmHA eligibility, what would be the effect on the rural economy of North Dakota? What would be your judgment on that?

Mr. BERGMAN. I guess my judgment on the economy, on the rural economy it would be devastating because of the rural communities it's going to destroy. Someone mentioned earlier this morning, someone is going to farm that land—it has been to this point in time. But who's going to farm it? Are we going to have family farmers? Or are we going to change the structure of agriculture? That's our deepest concern. Why should a Federal agency be a part of changing that structure?

I can only say that most farmers that have contacted me, the farmer/members of our organization who are borrowers, find it very difficult to live under these rules. They find it difficult to understand why there can't be debt adjustment. They are not asking for forgiveness; they are asking for debt adjustment. And if that

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[1] See p. 135 for the prepared statement of Mr. Bergman.

adjustment can be made and they can write down to the appraised values and bring that loan—if the appraised values in fact in 1995 land is worth more and appreciated, as we hope it will, then they would bring it back in. So I think there are commonsense things that can be done.

I, too, know that chapter 12 is a big hammer hanging out there. But most borrowers and most farmers are reluctant to go through bankruptcy, not only because of the costs but because of the stigma of bankruptcy. I don't think that FmHA should have to have that hammer held to their head.

Senator CONRAD. From your analysis of these regulations, what is your sense of the percentage of those currently eligible who would be made ineligible by the proposed regulations? Do you have a sense of that from the work that you've done?

Mr. BERGMAN. Well, from the work we've done and talking to our members, our sense is much higher than—well, the 18 percent is extremely low, the 50 percent probably is reasonable. I would guess we are guessing in the neighborhood of 70 percent, or greater, will not become eligible.

Senator CONRAD. If you combine the numbers of those who fall off on the bottom end, which is 50 percent, and those who come off on the top, which is, according to some figures, 17 percent or 23 percent—you combine the two and you are at 73 percent.

Going into a new crop year, what kind of a situation would that create in North Dakota among farmers?

Mr. BERGMAN. Well, it would be devastating to the family farmers who need credit.

Senator CONRAD. Would it go beyond family farmers? I mean, I assume it would be a devastating blow to Main Street in North Dakota.

Mr. BERGMAN. I would concur with that, because most of our local small towns and the businesses therein, are supported by small farmers, or family farmers. Now, if this continues to erode those farmers, it will only destroy our State.

Senator CONRAD. Well, with that we are going to have to proceed. We've got just a few minutes left and we need to get entered into the record the comments from the GAO. I want to thank each of you gentlemen for appearing here today, for the excellent testimony you've provided. You've assisted this committee greatly in its responsibility to provide oversight, and I assure you that there is going to be an aggressive pursuit of the oversight responsibilities of this committee. I think the chairman has made that clear, and that is the clear intent and consensus of the membership of this committee. Thank you very much.

Mr. Crowley, Brian Crowley, who is the senior associate director of Resources, Community, and Economic Development of the General Accounting Office. I understand you are accompanied by Jim Yeager and John Wanska, who are the evaluators, who I presume did the work on this study.

Mr. CROWLEY. That's right, Mr. Chairman.

Senator CONRAD. If you would care to summarize, let me say to you that the full text of your work will be entered into the record, and we again very much appreciate your patience here today. This is an important matter for the committee, and we are very happy

to have the work that you've done entered into the record. That will be helpful to us. If you would care to summarize the conclusions of your work, and then we'll get into some questions as well.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JIM YEAGER AND JOHN WANSKA, EVALUATORS

Mr. CROWLEY. Mr. Chairman, let me just briefly announce that on my left is Mr. John Wanska, who is from our Minneapolis-St. Paul, field office, and on my right is Jim Yeager, from our headquarters staff.

Mr. Chairman, I will summarize my statement.[1] Much of it, some of the background material particularly, has been covered earlier in the day. I'd like to start off by covering two things. First I'm going to talk a little bit about the Farmers Home loan portfolio.

Last year we did an analysis, aged the portfolio, and showed how delinquent borrowers were. That was the first time that any information had been developed which showed the extent of the delinquencies in the Farmers Home loan portfolio. This year we have updated that, and there's a schedule attached to my prepared statement—it is on page 12—which gives you a capsulized view of what's happened during the past year. My statement also has some charts attached that show 10-year trends in FmHA's portfolio.

As you can see, from 1985 to 1986 FmHA's farm loan portfolio has somewhat stabilized. We now have just slightly fewer borrowers, slightly fewer numbers of loans, and the outstanding principal is about the same—increasing about $100 million. The number of delinquent borrowers has decreased somewhat, from about 97,000 down to 93,000. The number of delinquent loans has also decreased slightly. However, the total delinquent dollar amount has increased $400 million.

The outstanding principal on these delinquent loans has gone up just about $100 million. The number of borrowers over 3 years delinquent—those are borrowers who have not made a payment on at least one of their loans in 3 years to Farmers Home—has stayed about the same; it's decreased a little bit, but basically it's stayed about the same. These over 3-year-old delinquent borrowers make up about 40 percent of the total number of delinquent borrowers.

The delinquent amounts owed by borrowers over 3 years delinquent—and these are the amounts that are seriously in trouble, and probably will end up in default—they've gone from $4.8 billion to $5.4 billion. That's about 79 or 80 percent of the total delinquent amount that Farmers Home carries right now.

The outstanding principal owed by borrowers over 3 years delinquent has decreased slightly—by about $100 million—to about $6.9 billion.

Mr. Chairman, overall you can see the portfolio of Farmers Home does not look very good. About half of the portfolio is delinquent and in jeopardy of default.

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[1]See p. 144 for the prepared statement of Mr. Crowley.

Toward the end of last year, we received a congressional request from the former chairman of this committee to look at Farmers Home loan making regulations and practices. In December, 1986 we started to do some work on this request.

As you know, in January of this year Farmers Home proposed new regulations which included a new method of determining who would be eligible for a Farmers Home loan. We immediately restructured our work to see if we could determine what impact those new regulations would have on the eligibility of FmHA borrowers that had received loans in 1986.

We have completed some preliminary work and have already briefed your committee staff on the results. I would like to caution that this work is still ongoing and we can only provide preliminary results. The figures are not projectable. That is, I cannot tell you whether 50 percent of the borrowers in this country are not going to make it under the new regulations, or anything like that. I can tell you what we found, and I can just briefly tell you some thoughts we have on that.

I would also add that we are looking at the Farmers Home portfolio as a loan program, and when we look at it as a loan program, we are trying to see if there is a way to make it financially better. From that perspective, Farmers Home—in its attempt to improve the financial condition of its portfolio—is going in a direction we support. How well they are doing that job is still something that we all have to look into and, of course, critique.

If you look on about page 7 of my prepared statement—in our preliminary work we looked at two counties in two States. The method we used for selecting the States, counties, and individual borrowers we reviewed is spelled out in my testimony. Essentially they are fairly representative sample—but, as I said, not projectable to all FmHA farm borrowers. We looked at 28 borrowers, and of those 28 borrowers, 14 would not have qualified for a FmHA farm loan under the proposed credit scoring system. Of those 14 potentially ineligible borrowers, 2 had farm and home plans that showed they didn't have a cash-flow. As such, they shouldn't have received a new loan under FmHA's current loan-making criterion, which is a cash-flow criterion.

Seven of the ineligible borrowers were technically insolvent, which means that their total assets were less than their total debts. If these borrowers had to liquidate tomorrow, the Government obviously would be taking a loss on them. The technically insolvent borrowers received about $210,000 in additional loan funds, and had loans in the amounts of about $453,000 serviced for more favorable loan rates and terms in 1986.

The 12 borrowers with positive cash-flows would have negative cash-flows without nonfarm income, indicating that these farm operations by themselves were not financially viable with the borrowers' current debt loads. Also these 14 borrowers, who on an average had been with Farmers Home for just under 6 years, have received about $2.2 million in loans and have not repaid approximately $1.9 million as of January of this year.

This amount of unpaid principal outstanding, which is 88 percent, indicates that the borrowers have made little progress toward freeing themselves from subsidized credit.

Eleven of the fourteen borrowers had their equity decline while receiving financial assistance from Farmers Home. And I think that's an important point to remember Mr. Chairman. Some of these people are borrowing themselves into oblivion. They continue to borrow, and to borrow, until they burn up what little equity they have left. At that point they are forced to leave farming and have nothing to show for their years of hard work. As a personal point that I want to make, we need to look at the possibility of offering some different programs here, about how we transition people from farming.

Mr. Chairman, that pretty much summarizes what I had to say. I'll be happy to respond to any questions you might have.

Senator CONRAD. This obviously is a limited sample, 28. The other work that's been done, the attorneys general staff work that has been done that showed 50 to 70 percent, according to the extensive sampling that they had done, would become ineligible, tends to confirm the initial numbers that have come out of your work.

Is there any reason to believe that the 28 that were selected in your sample were not representative?

Mr. CROWLEY. Yes, there is. It may not be representative at all. We would like to—in fact, we have plans to go to additional counties to see how it plays out. There may be special situations. You know yourself the country is different, we have different problems in different areas. The places that we went to in Iowa and Wisconsin are not typical of other areas in the country.

Senator CONRAD. You have plans to do that?

Mr. CROWLEY. Yes, we do.

Senator CONRAD. Do you have plans to extend your study to further counties, and, if so, what's the timetable for that and when might we expect the data from a study like that?

Mr. CROWLEY. We have not yet finished our preliminary work. What we would like to do is examine the potential impact of the proposed credit scoring on another 160 borrowers. To do that, under the current staffing that I have available, means that we would not complete our work until the fall or later.

If you have some particular things that you would like done quickly, we can work with your staff to expedite that, or we can work with your staff any way you want to provide you the information you need.

Senator CONRAD. I think that would be very important to the committee that we have, as quickly as possible, a further look at the numbers who would be affected, and staff can coordinate with you on that matter.

Mr. CROWLEY. Okay.

Senator CONRAD. Let me ask this question. How important is nonfarm income to those that were reviewed in your study?

Mr. CROWLEY. We looked at 28 borrowers; 26 had positive cashflows. Only 10 of them would have cash-flowed with only farm income. In other words, 16 of them would not have cash-flowed without nonfarm income. So I would say it was very important.

Senator CONRAD. Very important.

Mr. CROWLEY. Very important.

Senator CONRAD. And so any system that would preclude consideration of off-farm income would obviously be one that would have rather adverse consequences for those who are borrowers.

Mr. CROWLEY. We brought that to Farmers Home's attention while we were doing our work. This came out as being one of the potential problems with the proposed system. We understand that Farmers Home is now revising its proposal to include nonfarm income. That was something that we talked to them about very early on.

Senator CONRAD. You indicate that the farmers in the study who would not qualify under the proposal and have been with FmHA on the average of just under 6 years have made little progress toward freeing themselves from subsidized credit in this period.

Do you find that surprising, given what's happened to the farm economy in the last 6 years?

Mr. CROWLEY. Not surprising for this particular group of borrowers. Remember, these borrowers overall, their financial condition would make them ineligible for further credit assistance. We just brought that figure in to give you an idea of how seriously stressed these people are.

Senator CONRAD. Let me just ask you a follow-up to that. You indicate that 11 of the 14 that you've studied who would fail to qualify under the proposal had equity declines. Was that the result of production problems that would be to the responsibility of the farmer or were those the result of a decline in asset values and lower prices basically outside the control of the farmer?

Mr. CROWLEY. Mr. Chairman, we did not look specifically as to why these 11 lost equity during this period. I can tell you that, based on past work, when we have looked at people who have failed, who left farming voluntarily or who have been bankrupt, normally it is not just one element that has put those people under. It is a combination of the elements including those that you mentioned. It includes mismanagement in an environment that will not tolerate it, personal problems, high debt load, as well as lower prices, and high interest rates. It's often a combination of these factors; not attributable to just one in particular.

Senator CONRAD. Let me just make the observation that I would say in the early going we found cases certainly of mismanagement. Always there are going to be some out there who aren't as strong a manager as others, but I've found in my own observation in my home State that we are now getting into a group in which you find very little real management problems, unless you would want to assert that somebody who bought land 6 years ago should have known that prices were going to collapse.

Let me ask this question. Did any farmers in the study which would not qualify under the proposal show a positive cash-flow in 1986?

Mr. CROWLEY. Yes, 12 of them did.

Senator CONRAD. And how accurate will the values of assets be that are used in the credit scoring system for the prescreening that FmHA has proposed?

Mr. CROWLEY. They are going to be as accurate as the farmer makes them. The prescreening process is based upon what a farmer asserts the value of his assets to be. So the determination is

basically going to be on how accurate that farmer is when he walks in and tells Farmers Home the value of his assets.

Senator CONRAD. I may have other questions that we will submit to you in writing.[1]

I ask that you do expedite a review of other counties so that we might make judgments here that are based on as factual a determination as possible as to the number of people affected. That's critically important to us. We don't have much time. As you know, we are getting close to the next planting season, and from all of the testimony here today the effect of these regulations, these proposed regulations, if in fact they were implemented, would be devastating to the new planting season in terms of farmers' making judgments as to whether or not they are able to go ahead.

I want to thank you for the work that was done here. I also want to thank you for your patience. We'll have some questions that we will submit to you.

Mr. CROWLEY. Thank you, Mr. Chairman, and we will get together with your staff and work things out with them.

Senator CONRAD. We will adjourn this meeting of the committee on Agriculture, Nutrition, and Forestry, and I want to formally thank everyone for the record who has participated and made this hearing a success. Thanks to all of you again for your patience.

[Whereupon, at 1:24 p.m., the committee adjourned, subject to call of the Chair.]

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[1] The questions from Senator Conrad and Mr. Clark's responses thereto were too voluminous for reprinting and have been retained in the committee files.

APPENDIX

Statement of Hon. David L. Boren, a U.S. Senator From Oklahoma

Mr. Chairman, I commend you for calling this hearing to discuss the proposed Farmers Home Administration regulations. I am vitally interested in the operation of the FmHA and the role it serves as we all attempt to address the farm credit dilemma gripping our Nation's agricultural producers.

I was pleased the Administration extended the comment period on these regulations. It is my hope that the Administration will heed the comments received today and incorporate the suggested changes into the regulations where applicable.

The Farmers Home Administration was created and is intended to be the lender of last resort. As such, the FmHA is called upon to perform an increasing role for the estimated one-third of the family-sized agricultual producers who continue to experience financial problems. There are many producers who have never suffered financial difficulties but who now, after consecutive years of low prices, need some assistance. The Farmers Home Administration must be able to help these farmers through their temporary difficulties. In that sense, the agency must follow its original purpose and truly be the lender of last resort.

I am extremely concerned about the proposal which would not permit non-farm income to be counted as part of the farmer's cashflow in the preapplication screening for determining eligibility for loans. As most of the committee members are aware, I generally do not support providing Government agricultural assistance to those who do not rely on agricultural income for a substantial part of their income. However, at the same time, given the depressed state of the agricultural economy, many producers have been forced over the past few years to take outside jobs just to keep their farming operation alive. One would hope that profitability in agriculture will return and these producers can fully focus their efforts on their farming operation. Until the time, it would seem quite proper to count their total income in determining eligibility. I hope the department will modify the proposed regulations to reflect this.

Mr. Chairman, there is a general frustration with the Farmers Home Administration and the Farm Credit System. It is my hope that we can alleviate some of this frustration with sound, clear, uncomplicated and reasonable rules and regulations which follows the intent of Congress.

Statement of Hon. Kent Conrad, a U.S. Senator From North Dakota

I want to publicly thank Chairman Partick Leahy for calling these hearings on the Farmers Home Administration. I know the farmers and ranchers of North Dakota also appreciate his efforts.

I would also like to express my appreciation and the appreciation of my state to Senator Leahy for having brought the Senate Agriculture Committee to North Dakota and other midwestern states. It was at those hearings that farmers expressed their concern over the proposed FmHA regulations.

I do not need to emphasize the importance of FmHA for the farmers and ranchers in North Dakota, but, for the benefit of my urban friends, let me point out some facts.

1. In North Dakota, nearly one-third of the state's farmers and ranchers use FmHA loan programs.

2. The farm income necessary to repay these loans has fallen by 40% or more since 1980.

3. The value of assets collaterallizing those loans has also fallen dramatically—farmland values in my state are down nearly 50% in 6 years.

4. Commercial banks and the Farm Credit System which normally supply credit to farmers are under severe stress and have reduced their lending by $13.5 billion in 1985 and alike amount in 1986.

Many, many good family farm operations in North Dakota and other states are in serious trouble and are being pushed out of farming by the depression in agriculture. Local, state and most federal officials are attempting to stabilize agriculture and the rural economy. But, at a time of depressed farm income, falling farmland values, and a squeeze on commercial farm credit, the FmHA is proposing regulations which will disqualify up to 50% or more of current borrowers, according to an analysis by midwestern attorneys general. Instead of devising strategies to assist viable family farmers; strategies to stabilize the rural economy; the FmHA has proposed a strategy that will harm family farmers and destabilize the rural economy; the FmHA has proposed a strategy that will harm family farmers and destabilize the rural economy.

The Farmers Home Administration was intended by Congress to provide credit to farmers unable to obtain credit elsewhere. Now the FmHA proposes regulations which will allow it to compete with commercial banks rather than act as a lender-of-last-resort to farmers.

Numerous problems exist with FmHA's proposed regulations. Let me give you one example: The United States Code (7 U.S.C. 1942(A)(3)) states that ". . . loans may be made . . . to meet other essential farm operating expenses including cash rent . . ." In my area of the country, cattlemen rent grassland for cash rent to graze their herds; retired farmers rent their cropland for cash rent to avoid complications with social security. And, FmHA insists on cash rent, in advance, on land they have acquired.

Now, in apparent contravention of the law, and in the face of long established practices, and the FmHA's own requirements for land they have acquired, FmHA proposes to prohibit loans for cash rent.

This is just one small example of the carelessness with which these regulations were written.

These regulations have made clear that the current Administration wishes to sharply reduce the role of FmHA in the credit markets in the face of a serious farm recession further destabilizing a very fragile rural economy.

Today we are interested in determining why FmHA is so reluctant to play a positive role in the current farm crisis; why they have proposed regulations in contravention of the intent of Congress and, often, of the law of the land; and what process they went through in preparing these regulations.

Finally, I would like to publicly thank Mr. Alan Bergman and Carl Limvere, President and Vice President of the North Dakota Farmers Union, and Mr. Frank Kirschenheiter, Chairman of North Dakota's Credit Review Board, for sharing their experience and wisdom with us today. And, I would like to express my special appreciation to Nicholas Spaeth, Attorney General, and Sarah Vogel, Assistant Attorney General, of North Dakota, for their hard work, determination and devotion to assuring that the farmers of my state and all of America get a fair deal from the Farmers Home Administration.

Again, thank you Mr. Leahy for holding these important hearings.

Statement of Hon. Pete Wilson, a U.S. Senator From California

Mr. Chairman and fellow committee members, I am pleased that this committee is focusing on the farm credit crisis which American agriculture currently faces, and I am sure that rural America will be relieved to learn that this issue is being addressed with the seriousness that it deserves.

As members of this committee know, the Farm Credit System (FCS) currently holds more than a third of the total farm debt held by agricultural lenders. With the continuing decline in land values due to lower farm income, dismal prospects for future income growth, and a drop in the value of farmers' assets, the FCS could potentially face a disastrous collapse as early as July 1 of this year.

Last Congress, we passed numerous farm credit measures, which I supported, to maintain a viable Farm Credit System that will have the ability to meet the needs of American agriculture. Included in these legislative actions were the 1985 Farm Credit Amendments Act, which, in effect, made the Farm Credit Administration a more effective arm's length regulator of the FCS, and the 1986 Farm Credit Act Amendments, which, among other things, provided for regulatory accounting practices to allow institutions to amortize over 20 years certain specified expenses.

However, these actions were only, in my view, an important first step to illustrate congressional determination to solve the farm credit problems that threaten our Nation's farmers. Many unresolved matters still remain, including concerns regarding commercial lenders and the Farmers Home Administration, which are also major sources of credit for American farmers. In addition, I believe that we must focus our attention, once again, on the Farm Credit System to continue the rebuilding process to ensure that this source of credit is available to those agricultural producers who need it.

As we speak, Mr. Chairman, there are several farm credit districts that are experiencing serious financial difficulty. Some are facing financial collapse—districts in Kansas, Nebraska and Washington, for example. The farm credit district in Sacramento, California has not yet been faced with this worst case scenario. However, I do not wish to paint a rosy picture of the farm credit situation in my State. Many agricultural producers in California are finding it a difficult and painful process to obtain adequate financial support.

I can hardly say that there are any easy solutions to the problems that plague our Nation's farmers, but I am hopeful that though this morning's hearing and other committee efforts, such as the farm credit hearings that were held just a few weeks ago by my distinguished colleague, Senator Boren, we will send a signal to American agriculture that the farm credit crisis will receive the congressional consideration that it needs and deserves.

In closing, I would like to indicate my strong desire to work with members of this committee to develop an effective and viable solution to our farm credit problems. Thank you.

STATEMENT OF RON ALLBEE, COMMISSIONER OF AGRICULTURE, STATE OF VERMONT

Mr. Chairman, it is a pleasure to appear before this committee today with you sitting as Chair. We in Vermont are proud that a Vermonter is again in the chair. The last time this happened was when George Aiken served the state so well in the U.S. Senate. You are a leader in your own right and we in Vermont and in the Northeast value your leadership.

In Vermont and the Northeast, Farmers Home is not only the lender of last resort—it is one of two principal agricultural lenders in the region. As private lenders have withdrawn from lending, Farm Credit and Farmers Home have become the main agricultural lenders. Farmers Home accounts for 32% of the Real Estate lending in the Northeast. In the state of Maine, Farmers Home provides over 60% of the real estate credit. At a time when the rural areas of this country are suffering, at a time when our rural residents need further assistance and credit, it appears that the Farmers Home Administration is attempting to reduce any commitment to the rural residents of this country.

I will address my remarks to four items in the proposed regulations. The preapplication process, the State Director's authority, balloon payments and provisions under the guarantee program which prohibit guarantees when the farm activity would add to the national surplus.

The preapplication process, perhaps well intended, will become another paper hurdle. The process will add another confusing layer to what has become a confusing system. Our farmers need assistance, not aggravation. They need help, not harassment. For many, the ratios will be difficult to understand and apply. The ratios themselves do not tell the entire story. All of us know that ratios only provide a broad indication—they don't tell if a person has the management ability to make a living at farming.

Under the guaranteed portion of the regulations, loans may not be provided to an enterprise if it will contribute to a surplus. Broadly speaking, that provision may prove useful. However, that provision does not recognize the regional realities of agriculture. While we have a national dairy surplus—we in New England are not a surplus region. In Vermont we are looking at the possibility of adding value added processing to make new dairy products. If we are to succeed we may need additional supplies of milk. The proposed regulatory restriction should be modified to reflect regional variations.

Balloon payments for chattel mortgages are allowed under these proposed regulations if the applicant is also secured with real estate. If we truly want to provide credit to rural applicants, we should provide a state with as much flexibility as possible. Certainly, if a person is secure with chattels balloon payments should also be allowed without additional security.

Finally, the State Director is allowed under this proposal to overturn a positive recommendation by the country committee. County committees are lay people who know the applicant. They also take their jobs seriously and contribute a great deal to the process. You should oppose any attempt to give the state director further discretion which would weaken the role of the county committees.

Finally, Mr. Chairman, I want to relay to you a great deal of concern which exists among borrowers in the Northeast relative to the Farm Credit System. I know that you have received communication from the New England governors relative to their concern. I want you to know that there is no disagreements among the Springfield District and other Districts relative to the main issues facing the Farm Credit System. Borrowers in the system, no matter where they exist, need the reaffirmation that a strong and viable Farm Credit System, as well as an effective Farmers Home program, will continue.

Mr. Chairman, I thank you for the opportunity to make my brief comments. I just want to underscore the importance of Farmers Home to the rural areas of this country

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STATEMENT OF FRANK KIRSCHENHEITER, CHAIRMAN, CREDIT REVIEW BOARD OF NORTH DAKOTA, BISMARCK, ND

Mr. Chairman, Honored Senators, ladies and gentlemen—good morning!

For the record, my name is Frank Kirschenheiter, I am a farmer from southwest North Dakota, I live near the town of Taylor. I appear before you today as Chairman of the Credit Review Board.

I wish to thank you for the opportunity to testify this morning.

I appear here today as a result of the efforts of many North Dakota farmers, ranchers, business people and concerned citizens who were willing to donate $10 each to get me here to express the concerns that we in North Dakota have.

I offer to you written testimony for your consideration and ask your patience in my verbal testimony as I'm sure it will vary from that presented to you.

In January of 1971, my father passed away and I became a farmer at the age of 20 with the grim task of raising three younger brothers and sisters, and becoming a support for my mother.

We were never a large farming operation; at that time only 800 acres compared to a western North Dakota average of 1,200 acres, so the struggle was uphill. .

My father had share cropped with his mother from the time he came home from World War II until his death. Consequently, after his death, we had little to no real estate and a minimum of chattels with debt against them.

With my lack of experience, even our local bank was reluctant to be our operating lender. He suggested we look into the possibility of obtaining FmHA financing to allow our chattel debt to be paid off at a lower interest rate and over a longer period of time. Truly, I went to the "lender of last resort."

The concerns I express to you today are my concerns as an FmHA borrower, my concerns as chairman and negotiator for the Credit Review Board, and the concerns of North Dakota citizens who are so keenly aware that as agriculture goes, so goes North Dakota.

We are afraid this administration, through its implementing of new regulations, is taking away the "lender of last resort."

We see a farming community getting smaller and growing older. We see our small towns getting smaller; our churches and schools emptier.

We need to restock our farms with young farmers. In these troubled times in agriculture, we need the "lender of last resort" to accomplish this.

Our fears are that Farmers Home Administration's new and proposed regulations will only force more young farmers from the land and compound the problems.

The farm economy over the past few years has been a disaster, we all know that. During that time, FmHA has allowed its country supervisors to reschedule and reamortize debt if the farmer could cash flow the restructured debt the following year. In 1987 (page 1766 of January 15 Federal Register) the present administration has decided that unless there is equity in land or chattels securing debt, the debt cannot be rescheduled. Once again, FmHA attacks the younger farmer, because loans made on a one to one debt to asset ratio have not built equity. Not at a time when land values are plummeting and chattel values are sliding; they have lost equity, they are technically insolvent, and with administrative guidelines like this, will lose their farms.

In the past when a farmer restructured his entire debt and would refinance with FmHA, he could receive a non-disturbance agreement from some of his unsecured

creditors, which would simply state that the unsecured creditor would agree to waive payment on debt for one to 7 years. In 1987, the present administration has said that any cash flow must include payments on all debts. (Administrative Notice No. 1492 (1924).)

This action will push farmers, whom FmHA recently refinanced, into a negative cash flow, which will disqualify them for servicing options or additional operating monies, thus starving them off the land.

Farmers Home loan applications have gone from two rather simple forms to a complex packet which overwhelms many potential and existing borrowers.

In the past year, Farmers Home Administration has established the use of 1962-1, a nightmare for farmers and county supervisors.

This administration has actively encouraged the use of guaranteed loans. The lenders of North Dakota have responded and the rolls of North Dakota FmHA borrowers has grown from 6,000 plus to over 8,200.

Now FmHA proposes to restrict the issuing of guaranteed farm ownership and operating loans if the loans are used to increase the production of a commodity already in surplus (page 1777, January 15, Federal Register), and they indicate this program may end after 1988. With the curtailment of direct loans and the end of guaranteed loans, surely we will have lost the "lender of last resort."

In 1987, FmHA proposes to have their borrowers negotiate crop share agreements with all of their landlords by disallowing the use of operating loans for payment of cash rent (page 1712, January 15, Federal Register). In North Dakota, where most land is rented on a cash basis, this would be nearly impossible and more young farmers would be forced from the land because of diminished cash flows. In my own case, it would mean losing the use of over three-fourths of the land I now farm. One might add that this is a direct contrast to what FmHA does with their acquired properties where full cash payment in advance is requested.

Farmers Home employee positions during this administration have been cut year after year, while in private banking the opposite has been true. At a time when the needs are as great as they are now, the farmers need a supervisor they can walk in and see, not one they need a two week appointment before the supervisor is available.

The supervisors need to be trained to be supervisors, and need FmHA regulations to simplify restructuring so they are able to supervise beginning farmers and help them become the strong base agriculture and America will need in the future.

With the added supervision, a beginning farmer would be more likely to become a sound borrower eligible for graduation to the private lending sector, rather than one who gets his loan and is then forgotten until servicing time.

This young farmer could then pay his debt off and become a taxpaying citizen, not a delinquent FmHA borrower who has not paid taxes in years and is looking to become part of the increasing burden on this nation's social and welfare programs.

These are examples of simple regulatory changes that have been implemented and are proposed by this administration which have wide and devastating effects on Farmers Home Administration's young farmers.

FmHA has extensively used Limited Resource Interest Rates for the past several years. This type of interest rate is 3% below the normal rate and was used in an effort to make farmers cash flow in spite of current market trends.

I have attached to this testimony a form letter mailed to all FmHA borrowers in North Dakota every fall explaining limited resource rates. It clearly states, "Due to the complex nature of the problem facing this applicant, special help will be needed and more Supervisory Assistance will be requried to assure reasonable prospects of success."

This statement is a true reflection of what a COUNTY SUPERVISOR was intended to be when Farmers Home was started over 51 years ago.

It is the additional effort that the "lender of last resort" was willing to offer to get beginning farmers on the land. Unfortunately, regulation after regulation has handcuffed county supervisors and made them county debt collectors.

For the past four years, I have worked as a negotiator for the Credit Review Board/Farm Credit Counseling program in North Dakota. I see the frustration State and local FmHA personnel experience watching farmer after farmer lose their land because of today's economy.

They are powerless because of the lack of regulations to negotiate a settlement or restructuring agreement to keep that farmer on the farm, to keep his children in the local school system, to keep his family on main street of our small towns and keep our small businesses alive.

In June of 1986, several Senior Negotiators for the Credit Review Board had an opportunity to express to the current FmHA Administration the need for regula-

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tions to allow for the restructuring of FmHA debt. We tried to explain the logic of such regulations, and while it was conceded that perhaps the losses would be no greater, the response we were given was, "But if there were logic in this world, man would ride side saddle."

Might I suggest that every farmer in trouble will start riding side saddle tomorrow morning if only FmHA would start to implement regulations with "logic."

According to the Census of Agriculture, North Dakota was losing 550 farms and/or ranch operations per year during the decade of the 70's. During the first half of this decade, however, an estimated 1,200 farms per year have been lost.

The people of North Dakota are fearful of the consequences of such an increase and are working to slow it.

The North Dakota Legislature is considering legislation that would allow the State Land Department and Bank of North Dakota to restructure and reschedule their loans (Senate Bill 2207 and House Bill 1180). They are considering legislation to create 90% guaranteed loans on a limited basis to farmers and small business people (House Bill 1584, Senate Bill 2516). They are considering legislation which would allow separate redemption of the homestead (Senate Bill 2469). All of this in 1987, not 1937.

Farm Credit Services in North Dakota has reviewed 659 non-accrual (overdue beyond 180 days) loans in 1987. Of these, 292 were restructured viable units at $61 million dollars; 57 were restructured workouts at $16.7 million dollars; 211 were cash deals at $32.6 million dollars; 99 involved deedbacks to FCS at $15.1 million dollars. FCS reported a 20% greater return on the workouts of viable units than with deedbacks.

In neighboring Minnesota, Farm Credit Services Seventh District has worked with that State to establish a beginning farmer program. FCS would offer lowered interest rates to beginning farmers with as little as 10% down payment to purchase real estate.

The North Dakota Legislature has formally combined the Credit Review Board and Farm Credit Counseling program, and is designating nearly $1.5 million dollars of Bank of North Dakota profits to help this organization negotiate debt settlements between farmers and lenders. The program is currently working with over 1,400 farmers and are supported by farmers and lenders across the State.

Of the farmers the Credit Review Board/Farm Credit Counseling program worked with last year, 82% are still on the farm. Most of these have gone through some sort of restructuring from lowered interest rates to partial conveyances in satisfaction of their debt.

The lending institutions have negotiated agreements that cost them $62,000,000 in the first six months of 1986. Much of the cooperation between lenders and negotiators is realization that Chapter 12 may be a philosophy as much as a law, and that philosophy states any debt above current market value cannot be serviced given the current status of the farm economy. Also, it is greater benefit to the local community, the state and the nation to keep our farmers on the land. The lenders and citizens of North Dakota see the importance of peaceful settlement, rather than costly litigation. FmHA's current and proposed regulations allow only for litigation and bankruptcy; they need to have the flexibility to negotiate peaceful settlements.

Surely when a State like North Dakota and its people and lending community are working so hard to keep our people on the land, the federal government could implement regulations so that our "lender of last resort" would be part of the family.

The only regulation which Farmers Home must adhere to regarding debt restructuring is the recently enacted Chapter 12 bankruptcy code. It is sad to think the "lender of last resort" would become the target of this act.

H.R. 1050, introduced to this Congress by Congressman Byron Dorgan, would mandate FmHA to implement regulations to comply with Section 1309 of the Food Security Act of 1985. It is appalling to think the "lender of last resort" under this administration would not respond to that act and would need additional legislation to bring them in tune with the private sector.

What is needed during these hard times on the farm is an active "lender of last resort," not a collection agency.

First, they need logical regulations which would allow for restructuring and adjusting debts to current borrowers and keep them on the land.

Second, they need a renewed direct loan program so that funds are once again available for the purchase of real estate. Then young farmers wanting to start farming could have a source of financing.

Third, direct operating loans are needed to shore up the confidence of existing and new borrowers, and to assure that input monies would be available to assure lender success.

Fourth, Farmers Home needs to once again offer rural housing loans to its borrowers so they can build homes on their farms that are adequate and efficient. These homes don't need to be in town, but out in the country where the farmer's heart is.

We don't need farmers living in town and farming in the country. This robs from our productivity and threatens the lifeline of our R.E.C.'s, which are so vital to today's farms.

We do need our "lender of last resort". We need them as a friend, as an ally. We need them at our side in these troubled times, just as they were at the side of my father in the 50's, and just as they were at the side of so many farmers over 50 years ago.

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Dickinson, ND, November 14, 1986.

MR. FRANK KIRSCHENHEITER,
Route 1, Box 20A,
Taylor, ND.

DEAR MR. KIRSCHENHEITER: The Farmers Home Administration (FmHA) has authority under the Consolidated Farm and Rural Development Act to make limited resource farm ownership and operating loans to qualified applicants and FmHA borrowers.

The program provides credit at reduced interest rates to low-income farmers and ranchers whose farm operations and resources are so limited they cannot afford the regular interest rates for FmHA loans. The program is also intended to give beginning farmers and others a chance to receive the capital necessary to start a successful farming operation.

Borrowers with existing farm ownership and operationg loans who qualify as limited resource operators may have their loans reamortized or rescheduled at the limited resource interest rate.

A limited resource applicant is an applicant who is a farmer or rancher and is an owner and/or operator of a small or family farm (a small farm is a marginal family farm), including a new owner and/or operator, with a low income who demonstrates a need to maximize farm or ranch income. A limited resource applicant must meet the eligibility requirements for a farm ownership or operating loan, but due to low income, cannot pay the regular interest rate on such loans. Due to the complex nature of the problems facing this applicant, special help will be needed and more supervisory assistance will be required to assure reasonable prospects for success. The applicant may face such problems as underdeveloped or improved production practices and other related factors. The applicant will not have nor expect to obtain, without the special help and low-interest loan, the income needed to have a reasonable standard of living when compared to other residents of the community.

If you would like additional information regarding the limited resource loan program and how to apply you should contact this office.

I will be more than happy to discuss the program in detail with you.

Sincerely,

JUDEEN J. BRUSSEAU, *County Supervisor.*

CREDIT REVIEW BOARD,
STATE CAPITOL,
Bismarck, ND, February 10, 1987.

OFFICE OF THE CHIEF,
Directives Management Branch, Farmers Home Administration, USDA, Room 6348, South Agriculture Building, Washington, DC.

DEAR SIR: The Credit Review Board of North Dakota was established by the 1985 North Dakota Legislative Session to administer the Home Quarter Act, and to assist troubled farmers in negotiating peaceful debt settlements with their lenders.

In these troubled farm times—and they are as such here in North Dakota as they are elsewhere, possibly more so—it is astonishing at best that FmHA could even conceive such a set of new regulations as those proposed in the January 15, 1987, Federal Register.

In our negotiations with other lenders in North Dakota, it appears they by and large are willing to go the extra mile to keep farmers on the land. Perhaps farmers are not the mainstay of the federal government; for every seven farmers lost to North Dakota, one more business, main street or otherwise, is lost as well. Our tax base is rapidly eroding and we must stop that erosion. FmHA, as lender of last

resort has been one of the State's best conservation efforts in stopping the erosion in the past. Now they propose to change the rules of the game and allow most, if not all, of their 8,200 North Dakota borrowers to wash out!

Our North Dakota FmHA has been very efficient in graduating FmHA borrowers. Consequently, we would have very few, if any, farmers who would fall into the "under 40% debt to asset ratio." With hardly any borrowers in this low risk group, most FmHA borrowers would score too high in the risk index to receive any further FmHA assistance.

P. 1712 3. States that farmers must negotiate a crop share agreement with the landlord on any land he might rent. This is completely unacceptable in North Dakota where almost all land is rented on a cash rent basis. One might add FmHA also requires upfront cash rent on leases of their acquired properties.

Many farmers may be able to negotiate a split rent—one half cash rent down in the spring and one half in the fall—but very few would be able to negotiate their landlords into a crop share agreement. How does one cash flow after losing land one has rented for ten years? How does one negotiate a share agreement on pasture and hayland? Perhaps one could give the landlord one-third of the hay (worth $40) and then buy it back for the same $40 when the cash rent was only $13 per acre the year before.

P 1709 states the State FmHA Director may reverse either a favorable or unfavorable decision made by a county committee. Perhaps the federal government should save itself the cost of all the county committees by eliminating them from the outset. Surely this would remove some of the democratic obstacles that get in the way of bureaucracy in administering the retreat of the federal government from farm lending.

P 1777 furthers these efforts by restricting guaranteed loans so they may not be used to increase the production of agricultural commodities such as crops, livestock, or livestock products, for such periods as are necessary, when the United States Department of Agriculture is taking action to reduce production of such a commodity.

Might I suggest this would eliminate most, if not all, guarantees in the State of North Dakota at a time when Farmers Home Administration has publicly acclaimed the use of guarantees as their role in farm lending.

I am enclosing for your consideration an example using Farmers Home Administration's Risk Management Index that was prepared for us by one of our Senior Negotiators. It is an example of a North Dakota farmer who would traditionally been considered to be one of our middle third farmers. We have been told these farmers are in danger, but would survive the crisis. It is alarming that this farm would, under the new risk management proposal, be ineligible for future Farm Home Administration services. Without servicing from FmHA, this farmer would not get operating monies for next year's crop season. Since FmHA is supposedly the lender of last resort, where does this farmer then go?

It alarms the Credit Review Board that at a time when lenders are moving toward restructuring options to allow our people to stay on the land, Farmers Home Administration would be going away from this mood of cooperation.

If all the proposed regulations were to become law, it would seem apparent to us that the most our negotiators could hope to accomplish would be to work peacefully with local lenders and move towards a chapter twelve bankruptcy. This would force Farmers Home Administration into accepting a position that everyone else would be willing to do peacefully through negotiation.

The Credit Review Board would urge Farmers Home Administration to work towards a means of more equitable debt adjustment which would avert the use of Chapter 12. Such means may be similar to those suggested by Sarah Vogel in the January, 1987, North Dakota REC magazine, with which Mr. Vance Clark has concurred.

We are forwarding copies of this article, along with Mr. Clark's response, to you. We would like to add that we would be very responsive to requests for additional comments or information you might have need of.

Thank you for your time.

Sincerely,

FRANK KIRSCHENHEITER, *Chairman.*
W.E. SUMMERS, *Member.*
GOTTLIEB STEINWAND, *Member.*

Enclosures.

U.S. DEPARTMENT OF AGRICULTURE,
FARMERS HOME ADMINISTRATION,
Washington, DC, January 21, 1987.

Ms. SARAH VOGEL,
Assistant Attorney General, State of North Dakota,
State Capitol, Bismarck, ND.

DEAR SARAH: Just a line to say well done. Somebody here shared with me your recent article entitled "Steps to take in dealing with FmHA".

Certainly, the issues you raised in your article, Sarah, are most appropriate for many North Dakota farmers who continue to endure the stress of the times and I think the advice you have given those farmers is good advice. I must tell you I take exception with nothing you have proposed.

I do want to share with you, however, that many of us agree that the Farmers Home Administration should perhaps allow debt compromise without requiring total liquidation. We continue to explore that possibility and I am working with Kathleen Lawrence, the Acting Under Secretary, to see if we can't go forward with that proposal. As always—it takes too long to do these things, but hopefully if we can get an agreement here at the Department of Agriculture that debt restructuring tool could be in the field later in the year which could be of benefit to many American farmers, including those of North Dakota.

Again, congratulations. I enjoyed your article. I hope we have a chance to meet and visit soon.

Sincerely,

VANCE L. CLARK, *Administrator.*

[Reprint from the North Dakota REC Magazine]

STEPS TO TAKE IN DEALING WITH FMHA

(By Sarah Vogel, assistant attorney general, specializing in agriculture-related law)

National and locally, many Farmers Home Administration (FmHA) loans are in trouble. FmHA borrowers, like all farmers, have been buffeted by low prices, high costs and declining land values during the last several years. However, FmHA borrowers are more stressed than the average farmer because farm ownership and operating loan borrowers start from a lower equity position and emergency loan borrowers are recovering from natural disasters. As a result, the FmHA loan portfolio is in far worse shape than that of other agricultural lenders. Only 17 percent of FmHA borrowers nationally fall below the "safe" 40 percent debt-to-assets ratio and an astounding 37 percent of its borrowers are indebted for more than 100 percent of their assets. In July of 1986, FmHA estimated that it may lose as much as $7.7 billion on its outstanding farm loans.

FmHA has stepped up its collection efforts since final regulations on debt collection processes were published in November 1985. During 1986, FmHA sent 1,669 notices of intent to take adverse action to North Dakota farmers. This notice (unless a borrower is able to obtain deferral or restructing of debt) is the first step to an FmHA foreclosure. To give you an idea of how many North Dakota farmers face the threat of FmHA foreclosure, 1,669 is just over five percent of our state's farmers and represents 19 percent of FmHA borrowers. The average county in North Dakota has almost 32 farms threatened with an FmHA foreclosure. As of December 1986, FmHA already held 78,500 acres of inventory farmland. If even half of those farmers who receive a notice of adverse action end up in foreclosure or convey their land back, the land FmHA owns will increase dramatically, and farmland values will drop dramatically. Clearly, these massive numbers cannot be viewed as mere statistics; they have a profound effect on many North Dakota families and their cooperatives, churches, schools and towns.

What can be done to mitigate, avoid or overcome the financial problems of FmHA borrowers? No one can promise a happy ending, but there are certain things a farmer can do that might help.

1. FmHA needs better debt restructuring for its existing borrowers. Write to Sen. Quentin Burdick, Sen. Kent Conrad and Rep. Byron Dorgan to see if they can help write laws to make FmHA allow debt compromise without requiring total liquidation by the existing farmer. FmHA will now let people apply for debt settlement only if they first totally liquidate or if they transfer the land at present market value to a new farmer. The taxpayer losses caused by forcing existing farmers off the land, managing the vacant land and buildings, and finding new renters or

buyers are huge. When FmHA gets the land, Congress requires that it be sold for only its productive value. Why not let existing family-sized farmers restructure their debts based on the productive capacity of the land?

North Dakota can't afford to lose all these farmers. Nor can local businesses in the farm service center towns afford to lose them.

Every person in North Dakota has a stake in helping as many FmHA borrowers as possible to survive. The Federal Land Bank of St. Paul and its borrowers, in particular, will be hurt by surplus FmHA land on the market.

2. Borrowers should respond to FmHA notices of adverse action. FmHA gives only 30 days to respond to the notice of adverse action. If you fail to do so, you're sunk. A good book, "Farmers Guide to FmHA," third edition, costs only $5 and in Chapters 6 and 7 tells you exactly how to determine your options if you get a notice of adverse action. It also tells you how to appeal if your request for loan servicing in lieu of foreclosure is rejected by FmHA. Order it from Minnesota Legal Services Coalition, 908 Minnesota Building, St. Paul, Minn. 55101. The state's credit counselors have the booklet and have been thorougly trained in how to respond to FmHA notices. Call for a counselor at 1-800-642-4752.

3. FmHA borrowers should respond to FmHA offers for dwelling retention. Congress requires FmHA to allow a former owner (who has lost his land through foreclosure, bankruptcy or conveyance) the first chance to lease the dwelling and up to five acres of surrounding land with an option to buy. It's important to know, however, that if you move away from your dwelling, you are ineligible for the dwelling retention program. This program has flaws—caused by an overly narrow law, restrictive regulations, and inadequate publicity about it at the state level—but it may help in some cases to provide a roof over a family's head and to provide a base for later regrouping. This program has some good features. For example, if you want to exercise the option to repurchase your dwelling, FmHA must finance it like a contract for deed. Again, this program has a 30-day deadline to respond.

4. FmHA borrowers should respond to FmHA offers to lease farmland. If you've already lost your land or may lose it, you nevertheless may be able to lease it back for a one- to three-year term. FmHA has forms and instructions for this program as well. Original owners are given a 30-day period to have the first chance for such leases, but an original owner's application will not necessarily be approved, because there are a number of restrictions. You must show, for example, that you have the ability and resources to farm the rented land. You also have to properly account for FmHA security during the period you were farming.

While the dwelling retention and farm land leasing programs are a step in the right direction, it would be better overall if FmHA on the national level would recognize that massive numbers of foreclosures will not help to recover debt that was improvidently lent in the first instance and which is, in part, virtually uncollectible. FmHA should provide better debt restructing programs to those family-sized farmers who, due to no fault of their own, can't now repay all of their outstanding debt but want to continue to farm and to retain their ties to the land.

Example of How FmHA Risk Management Index Works

(These ratios were derived by a combination of ratios used by FCS and other ag lenders)

This farming operation is based on the following financial information:

A. Farm has $193,000 in liabilities and $271,500 in assets for a total net worth of $78,500

B. Farm has $74,160 in gross income

C. Farm has $36,050 in operating expenses

D. Farm has $12,500 in family living expenses

E. Farm has $145,000 debt at FCS; terms are 25 years @ 12¾% interest for a yearly payment of $19,500

F. Farm has $48,000 debt at FmHA; terms are 15 years @ 7% interest for a yearly payment of $5,300

Farmer Program Loan Risk Index Worksheet

(All Assets Must be CMV)

1. Total liabilities/total assets = 71% or 3 points [$193,000] ÷ [$271,500].

2. Return on asssets = net farm income (before interest payments) divided by total assets [$271,500]. Net farm income is calculated by taking gross farm income

[$74,160] minus family living [$12,500] expenses minus farm operating expenses (excluding interest payments) [$36,050]. Total assets must be the current market value on the balance sheet. Totals of formula are [$25,610] ÷ [$271,500] = 9% or 2 points.

3. Balance available/total debt payments = balance available is gross cash farm income [$74,160] minus all cash farm operating expenses [$36,050] minus family living expenses [$12,500] minus capital purchases [0] minus nonfarm income [0] minus cash carry-over [0]. This balance available would then be divided by total debt payments which includes all principal and interest due. FCS [$19,500], FmHA [$5,300]. Totals of this formula are [$25,610] ÷ [24,800] = 103% or 4 points. The total of this farmer's points is 9. Applicants having a loan risk index of 9 or more will be disapproved by the appropriate FmHA loan approval official. Applicants having an index of 9 or more lack a reasonable prospect to be successful in this farming operation and have a high degree of potential loan failure or risk. If ratio number 3 is ever below one, you are automatically rejected, no matter what the other ratios are. The proposed changes in the Federal Register, dated January 15, 1987, do not explain what FmHA will do to a borrower who has existing loans at FmHA, but is current on all principal and interest. My feeling is they will be accelerated, but I don't know how FmHA can accelerate an existing loan which is current (law says they can't) but has scored a 9 or above on the risk index. It does state the county supervisor will immediatly notify the applicant in writing if he is rejected. Even if the borrower is not accelerated, he is not eligible for direct or guaranteed loans from FmHA. It does not say anything about servicing options still being available, but I suppose FmHA feels that all of those have been explored or used already. It is not clear what they will do. The farming operation on the previous page shows good equity and good return on assets, but mainly because of a tight cash flow, he would be disqualified for FmHA services, even though he has a 3% surplus of cash. If he is eligible after the risk management index, they may give hm L.R. which would give him another $800.00 for debt reduction.

Point system used to determine eligibility: 1—☐; 2—☐; 3—☐; 4—☐; the higher the number the worse off you are. Remember if you score 9, you are ineligible for direct and guaranteed loans.

1. Total Liabilities/Total Assets:
   40% or less ☐
   40%-69% ☐
   70%-99% ☐
   100% or more ☐
2. Return on assets:
   10% or more ☐
   9%-5% ☐
   4%-1% ☐
   0% or less ☐
3. Repayment ability margin (cash flow for the planned year):
   115% or more ☐
   114%-110% ☐
   109%-105% ☐
   104% or less ☐ (Remember FmHA said if this ratio is below 1, you will be automatically disqualified.)

When I prepared this example, I chose an actual case in North Dakota. We will have to see what FmHA does before we can decide on options. Right now everything is kind of put on hold as FmHA decides how the borrower will have to be treated if the new regs go into effect. This farmer didn't feel he was in trouble yet because he is current everywhere, but he wanted to talk to someone unbiased about his future in farming, so he called me. I also purposely chose a case that came very close to qualifying but didn't. You can plainly see what happens if a farmer scored any higher on any of the three ratios; he for sure would be disqualified and if you can't make it on FmHA low interest rates, you won't make it with borrowers anywhere else because of their higher interest rates. Another problem that exists is that FmHA requires current market value on all chattels and real estate on all asset figures on this application. In areas where land has declined in value dramatically, you will never get this risk form to work. But FmHA has no intention of writing assets down to CMV, unless the land changes owners. Other lenders have the same attitude. FmHA justifies this position because all non-FmHA borrowers who are making it would scream unfairness. FmHA also feels any other industry with government loans would do the same.

According to a G.A.O. analysis entitled "Financial and General Characteristics of Farmer Loan Program Borrowers" dated January 1986, out of 63,288 FmHA borrowers, 20% or 12,448 borrowers were technically insolvent (100% or over) debt to

assets; 31% or 19,743 borrowers had a 70% to 99% debt to assets; 32% or 20,076 had a 40% to 69% debt to assets; and 11,021 or 17% had a debt to assets percent under 40. More recent valuations done in 1986 from FmHA disclosed the composite average of 6,573 FmHA borrowers had an average debt to assets ratio of approximately 76%. Therefore, FmHA believes the ratios used in this risk management are sound. Using these figures, 51% of FmHA borrowers will not pass this risk management test and if the 76% ratio is correct, it could be much higher, possibly 83%? Transferring these percentages to your state's FmHA borrowers, you can figure the impact these regulations could have on your state's economy.

Prepared by Lane Landenberger, Senior Negotiator, North Dakota Credit Review Board, Bismarck, ND.

[The following material was submitted by the attorneys general enumerated below:]

ATTORNEY GENERAL,
STATE OF NORTH DAKOTA,
Bismarck, ND, February 13, 1987.

Re Comments on the Proposed General Revision of Farmer Program Regulations, 52 Fed. Reg. 1706 (January 15, 1987).

OFFICE OF THE CHIEF,
Directives Management Branch, Farmers Home Administration, USDA, Room 6348, South Agriculture Building, Washington, DC.

DEAR SIR: These comments are being submitted by Tom Miller, Attorney General of the state of Iowa; Neil Hartigan, Attorney General of the state of Illinois; Hubert H. Humphrey III, Attorney General of the state of Minnesota; and Nicholas J. Spaeth, Attorney General of the state of North Dakota.

We strongly object to many features of these proposed regulations. If adopted, these regulations would have a devastating effect on the farm economies of our respective states.

A summary of some of our major concerns are as follows:

Pre-Application and Application Risk Ratios

FmHA was established by Congress to provide credit to borrowers who cannot qualify for commercial credit. In essence, new risk ratios impose commercial credit standards on applicants for FmHA credit—an obvious inconsistency with FmHA's legislative mandate. We believe use of these ratios would disqualify about 50% of FmHA's existing borrowers from even being able to apply for credit from FmHA.

Surplus Property

FmHA has acquired many hundreds of thousands of acres of farmland nationwide. Due to its policy of starting adverse action proceedings on all farmers who are $100 or more delinquent for one year or more, FmHA will probably acquire much more land in the future through foreclosures or conveyances. To whom FmHA will sell this acquired farmland is a critical issue in farm states. FmHA has historically adhered to a law that requires it to restrict its sales of acquired farmland to family sized farms for a three-year period after acquisition. The proposed regulations would permit FmHA to auction its farmland to the high bidder only one year from acquisition. This is in clear derogation of the law and the historic mission of FmHA to help foster the family farms of America.

Usurpation of the Role of County Committees

The proposed regulations would allow FmHA staff members to usurp the historic role of FmHA county committees in determining who is eligible to apply for FmHA loans by allowing staff members to overrule favorable restrictions and by otherwise restricting the exercise of judgment by county committees.

Economic Barriers to Successful Farming by FmHA Borrowers

It is essential that FmHA borrowers be permitted to operate their farms on an even basis with non-FmHA borrowers. The proposed regulations would thwart FmHA borrowers' potential for success by such actions as prohibiting loans for cash rent (in clear contravention of statute), administrative declarations that particular commodities are "in surplus" and that further loans are prohibited for production in excess of the *lower* of the borrower's average production over the past five years or the past two years, prohibiting replacement of foundation livestock herds with line of credit guarantees, requiring cash reserves equivalent to depreciation allow-

ances, and requiring pledges of *all* assets for any loan (e.g., a farm would have to be pledged to get a crop loan).

Barriers to Beginning, Low Equity, and Reentry Farmers

FmHA has proposed a number of regulations (in addition to the risk assessment ratios discussed above) that would impede beginning farmers, low equity farmers and reentry farmers. For example, FmHA would require three years' experience in operating *and* managing a farm within the last five years before a farmer would be eligible to apply for a loan. It would also require preferences for existing borrowers, and, except in limited circumstances, prohibit loans to an applicant who has previously entered into debt settlement with FmHA.

Requiring Countywide Disasters for Emergency Loans

The proposed regulations would not allow any disaster loan unless the county as a whole suffered a qualifying 30% disaster loss. The law was intended to apply to both widespread disasters *and* more isolated disasters (tornadoes, floods, hail storms) that injure only individual farms or small groups of farmers.

Appraisals

In derogation of the law which requires FmHA to promulgate regulations to implement FmHA's appraisal process, FmHA proposes to simply delete the regulations on appraisals from the Code of Federal Regulations.

We also strongly object to the limited time period given to the public, members of Congress and affected farmers for comment on these regulations. Such massive changes in the historic operation of FmHA deserve more than a 30-day comment period.

Our more detailed comments on the proposed regulation comprise the remainder of this letter.

APPRAISALS

7 C.F.R. Part 1809

Deletion of Appraisal Regulations

We are deeply concerned with the proposed deletion of the regulations regarding appraisals. 52 Fed. Reg. 1713 (deleting 7 C.F.R. Part 1809). The statutes require FmHA to promulgate rules regarding appraisals. 7 U.S.C. § 1925. Although in the commentary preceding the rules, the agency asserts that appraisal regulations will still be available in FmHA offices, 52 Fed. Reg. 1706, this is insufficient. It is essential that all FmHA regulations be available in one location (the Code of Federal Regulations) if farmers and their advisors are to be adequately informed.

In the commentary, the agency claims that the appraisal regulations are merely "administrative . . . used to instruct FmHA field staff." 52 Fed. Reg. 1706. However, appraisal information includes standards as well as procedures. This information is crucial to a farmer and his financial and legal advisors if they are to accurately assess the farmer's status and FmHA's treatment of the farmer. In addition, the proposal will permit FmHA to modify the appraisal standards without notice and comment. This is contrary to Congress' express intent in requiring rulemaking on this issue.

For these reasons, Part 1809 should be retained.

APPEAL PROCEDURE

7 C.F.R. Part 1900

Adverse Action Letters

The proposed letters notifying applicants of adverse decisions are difficult to read and understand and should be modified if they are to adequately instruct applicants of their rights. *See* 52 Fed Reg. 1714 (to be codified at 7 C.F.R. Part 1900). As we have repeatedly urged in the past, all notices and letters from FmHA to applicants and borrowers should be written in plain English. For example, in Exhibit B-3, phrases such as "the facts relative to" and "a satisfactory conclusion" should be made clear and specific. *Id.* In addition, FmHA must supply adequate information in its notices. For example, in Exhibit B-4, the agency should explain or define "regular office hours," "non-confidential material," and "Freedom of Information Act." *Id.*

Hearing/Review Officer Designation

The proposed regulations permit an FmHA employee who participated in an adverse decision against an applicant or borrower to act as the hearing officer in the applicant's or borrower's appeal as long as the FmHA employee was not "significantly involved" in the decision under appeal. 52 Fed. Reg. 1714 (to be codified at 7 C.F.R. Part 1900). Fundamental fairness requires that any person hearing an appeal should be completely impartial. Such impartiality is accomplished only if the hearing officer has had no involvement at all in the prior decision.

APPLICATIONS

7 C.F.R. Part 1910

Risk Ratios

Section 1910.(4)(b)(1) requires that farmer program applicants must file a preliminary application which will be used to determine a preliminary loan risk index. The preliminary application will be rejected if the index is over 9 points. Applicants will be allowed to apply only if they score between 5 and 8 points. If a borrower is allowed to apply, he must survive yet another application risk formula. We believe that these ratios are inappropriate for use by the FmHA. FmHA was founded to assist farmers who are *unable* to obtain and finance loans from private commercial lenders. It is inconsistent with FmHA's basic statutory authorities to have FmHA apply the *same* credit standards used by private commercial lenders.

These formulas, which have been adopted from the ratios used by commercial lenders, would result in the rejection of as many as fifty percent of FmHA's existing borrowers. These formulas will result in the disqualification of virtually all beginning and low equity borrowers. For example, a beginning farmer would have to have better than a 5% return on assets and current assets exceeding current liabilities by 25% or more to be able to *apply* for either an OL or FO loan. We believe that few farmers indebted at the FmHA average indebtedness ratio (76% debt to assets) would even be able to apply for FmHA credit. At the other end of the spectrum FmHA estimates that 17% will not be approved because of their theoretical ability to obtain loans from commercial lenders. Additionally, the scores for the net income (before interest) minus family living/current assets ratio are derived from commercial lenders whose interest rates are much higher than FmHA's. These margins should not be necessary for FmHA with its vastly lower interest rates.

If FmHA implements these preapplication and application risk ratios, the farm economies of our states will be devastated. Denial of large numbers of operating loans by FmHA will lead inevitably to massive defaults on real estate loans that are now current and will lead to default on debts to main street suppliers.

County Committee Eligibility Determinations

FmHA county committee recommendations on eligibility are required by law. *See* 7 U.S.C. § 1983(b): "In connection with loans made or insured under this chapter [Chapter 50—Agricultural Credit] the Secretary *shall require* . . . the county committee to certify in writing that the applicant meets the eligibility requirements of the loan. . . ." Moreover, to strengthen county committees and to make them more responsive to the needs of local borrowers, the Food Security Act of 1985 requires that two of the three members be elected by the vote of area farmers. 7 U.S.C. § 1982(a).

Proposed § 1910.6(a) provides that if an applicant is found eligible by the county committee and the county supervisor disagrees with that determination, then the county supervisor can make a recommendation to the state director to overturn that favorable decision. If the state director agrees, he is to tell the county committee and the borrower why the eligibility decision was overturned. The borrower can then appeal only to the national office.

At page 1709, the sole explanation offered for this proposed change is that "Occasionally, county committees make decisions based upon personal opinions rather than regulations."

Reversal of over 50 years of FmHA practice and the explicit language of the law require a better explanation than that provided by FmHA. Indeed, several of the major decisions on eligibility that Congress delegates to FmHA county committees are obviously intended to be a matter of "personal opinion" by the county committee members. These include assessments of "sufficient training or farming experience to assure reasonable prospects of success," "needs to rely on farm income to provide a standard of living comparable to that considered in the area," and "char-

acter as it relates to debt payment, management ability and industry to carry out the proposed operation." *See, e.g.*, 7 U.S.C. § 1941(a), 7 C.F.R. § 1941.12.

We believe the proposed regulation is in clear derogation of Congress' clear intention to strengthen the role of the county committees and its long-standing policy that only county committees can determine eligibility.

If a county committee actually disregards regulations, there are less drastic alternatives available to FmHA. First, FmHA could increase the level of training available to county committees. (This training is now sketchy and inadequate at best.) Second, the county supervisor could advise the county committee of its alleged error in construing regulations *before* the matter is submitted to the state director. Third, the county committee could be given an opportunity to explain its position to the state director. Fourth, county committee members who deliberately disregard regulations could and should be removed for cause and replaced by a newly appointed or elected member.

We also strongly object to the diminishment of the borrower's appeal rights by this new procedure. Eligibility issues are closely connected to matters uniquely suited to local conditions and matters known locally, such as an applicant's reputation for industry. To force a borrower to appeal to the national office after eligibility is denied by the state director is very unfair. The borrower will generally be unable to attend the appeal in person and could not bring witnesses (including presumably the county committee) to Washington, D.C. Thus, the congressionally mandated appeal process will be a nullity as a practical matter.

Applications Pending Funding

Section 1910.6(e) permits the FmHA to take applications for RH, RRH, RCH, RHS, and LH loans when funds for these programs are not available. The proposed rule provides that applications received when funds are not available will be processed and a decision on eligibility will be made. Section 1910.6(d), however, forbids the acceptance of farmer program applications when all of the FO, SW, and OL funds allocated to a state during a fiscal year have been obligated. We believe this proposed rule should conform to the logic and procedure set forth in Section 1910.(6)(e). Funding for the range of FmHA loans should be administrated under a common procedure. We hope that the differing treatment of FO loans, for example, does not reflect the intent of FmHA to dramatically reduce FO funding and thereby make the taking of applications extraneous.

We would also point out that Congress has already determined the procedure to be used by FmHA when funds are exhausted in 7 U.S.C. § 1983a(b)(2). When funds are unavailable, the Secretary is to provide them within 15 days of availability. FmHA's concern for the confusion and uncertainty caused by underfunding would be better dealt with by a clear disclosure of the time that additional funding may become available.

MANAGEMENT ADVICE

7 C.F.R. Part 1924

Planning

FmHA has significantly revisedits regulation regarding the Farm and Home Plan. 52 Fed. Reg. 1723 (to be codified at 7 C.F.R. § 1924.57). While we recognize that some of the revisions are necessary to protect adequately the government's interests, several of the proposed changes are vague and require clarification. First, several of the requirements in proposed Section 1924.57(c)(5) are vague, including "major repairs," "reasonable standard of living," and "essential capital purchases or improvements." Subsections iii-v. Second, the section requires that the Plan be revised "whenever changes in the borrower's operation occur during the year." Subsection (d)(2). The regulation should specify what changes in the operation are sufficient to merit revising the Plan. Finally, the regulation requires that the Plan use "actual production and financial history for the past five years." Subsection (d)(1). This does not account for variations in a farmer's production resulting from intentional changes to his operation or due to circumstances beyond his control. It should be changed to permit adjustment for such factors. The importance of the Farm and Home Plan in an FmHA's borrower's relationship with the agency cannot be overstated. The regulations governing the Plan must therefore be as specific and clear as possible.

Supervision

As proposed, Form 1924-14 tells borrowers about certain loan servicing options which are available "to assist borrowers if they are not able to pay as scheduled."

52 Fed. Reg. 1724 (to be codified at 7 C.F.R. § 1924.59(d)). Information regarding FmHA's debt settlement, leaseback, and homestead retention programs should be added to this notice. The full range of a borrower's options must be made clear if he is adequately to assess and plan for his situation.

OPERATING LOANS

7 C.F.R. Part 1941

Cash Flow Requirements

Regarding the OL program's cash flow requirements, 52 Fed. Reg. 1725 (to be codified at 7 C.F.R. § 1941.4(m)) and 52 Fed. Reg. 1727 (to be codified at 7 C.F.R. § 1941.33(b)(1)(iv)), please *see* our comments regarding "Planning" above.

Credit Elsewhere

The proposed amendments to the regulations governing FmHA's credit elsewhere requirements, 52 Fed. Reg. 1726 (to be codified at 7 C.F.R. § 1941.6), are troublesome in two respects. First, the amendments require the county supervisor to consider "the applicant's pre-application loan risk index." Regarding our general concerns with FmHA's using such an index, please *see* our comments, *supra*, at pp. 4–5.

In addition to these general concerns, we are troubled by the agency's proposed use of the index in determining the availability of credit elsewhere. At best, the index may predict that credit should be available for a particular applicant. It cannot demonstrate whether credit is in fact available. The proposed amendment should therefore be withdrawn. At a minimum, it should be modified to explain how the index will be used in the county supervisor's decision.

Second, proposed subsection (d) authorizes the county supervisor to deny a loan if he "feels that the applicant can obtain a guaranteed loan." This provision gives the county supervisor unbridled discretion in determining whether to provide a loan. Guaranteed loans are very difficult for a farmer to obtain. Particularly in light of this difficulty, a county supervisor's "feelings" about the availability of a guaranteed loan are an inadequate basis for determining whether credit is actually available elsewhere. A farmer who is denied a direct loan for this reason will lose valuable time when he is then required to seek a guaranteed loan. If his search is unsuccessful, he may well end up with no operating loan for the year, particularly if the money available for direct loans is rapidly depleted.

Eligibility Requirements

The proposed amendment relating to training or farming experience, 52 Fed. Reg. 1726 (to be codified at 7 C.F.R. § 1941.12(a)(3)) requires such training or experience to be "in managing *and* operating a farm (within 3 of the last 5 years). . . ." [Emphasis supplied.] This requirement will seriously disadvantage beginning and reentering farmers—the groups of farmers most likely to have difficulty obtaining credit elsewhere. It takes away the discretion of the county committee to determine on the basis of their knowledge of the applicant's background whether adequate managerial ability exists. The rigidity of the rule may be illustrated by an example: an applicant's background whether adequate managerial ability exists. The rigidity of the rule may be illustrated by an example: an applicant operated his father's farm for ten years and after his father's retirement both operated and managed the farm for two and a half years. Such a farmer would be deemed ineligible. Similar results would apply to educational training. Many agricultural degrees are obtained from two-year programs. Thus, a graduate of a two-year vocational program in farm management who had not previously operated and managed a farm would not be deemed eligible. The current language of this subsection is sufficient to protect the agency from incompetent borrowers, and the proposed amendment should not be adopted.

Loan Limitations: Cash Rent and Debt Settled Farmers

The proposed amendments regarding loan limitations, 52 Fed. Reg. 1726–7 (to be codified at 7 C.F.R. § 1941.17), add two categories of OL loans which FmHA will not approve. These proposed subsections are contrary to the letter and spirit of FmHA's enabling legislation.

First, the amendments provide that "[a]n OL loan will not be approved . . . [t]o pay land lease costs including cash rent." § 1941.17(a)(5) as proposed. This proposed regulation is directly contrary to 7 U.S.C. § 1942(a)(3) which provides that "[l]oans may be made under this subchapter for . . . purchasing feed, seed [etc.] . . . and to meet other essential farm operating expenses *including cash rent*. . . ." [Emphasis supplied.] *See also* 7 U.S.C. § 1943. ("The Secretary shall make or insure no loan

under this subchapter . . . for the purchasing or leasing of land *other than for cash rent*. . . ." [Emphasis supplied.] Cash rent is a mode of operation likely to be used by beginning and reentering farmers. Moreover, many landlords insist on cash rent. (Ironically, FmHA itself wants only cash rent.) Congress obviously intends for FmHA to permit its borrowers to pay cash rent. FmHA's concern for shifting risk of loss is better addressed by the requirement of crop insurance elsewhere in the regulations.

Second, except in limited circumstances, the amendments prohibit approval of an OL loan if the applicant has engaged in debt settlement with FmHA or has been foreclosed upon. This provision unnecessarily penalizes reentering farmers even if they meet the eligibility requirements set forth in 7 C.F.R. § 1941.12 and even if they are able to lease or purchase their homestead and farmland under the new programs made available by the Food Security Act of 1985. In addition, the provision thwarts the intent of Congress in expanding the availability of debt settlement in the Food Security Act of 1985, P.L. 99-198 § 1707 (codified at 7 U.S.C. § 1981(d)). The purpose of Congress' amendments were to increase the borrower's flexibility. *See* S. Rep. No. 145, 99th Cong., *reprinted in* 1985 U.S. Code Cong. & Admin. News 1676, 2145. For the farmer hoping someday to reenter farming, this flexibility is nullified by the proposed amendment to 7 C.F.R. § 1941.17.

Rates and Terms

The proposed amendments regarding balloon installments, 52 Fed. Reg. § 1727 (to be codified at 7 C.F.R. § 1941.18(4)), are particularly troublesome. The circumstances designated as warranting balloon installments ("establishing a new enterprise, developing a farm, purchasing feed while crops are being established or during recovery from a disaster, or economic reverses") are exactly the circumstances under which a farmer is most likely to be unable to obtain credit elsewhere. As with many of the proposed amendments discussed previously, this provision will make it very difficult for beginning and reentering farmers to qualify for an OL loan.

This difficulty is compounded by two of the other requirements in the proposed amendment. First, the regulation will require "adequate collateral for the loan at the time the balloon installment is due." Because future collateral is likely to be difficult to predict, this provision invites abuse. In addition, the regulation will require a real estate lien whenever a balloon installment is required. In other words, a real estate lien may be required in all of the circumstances outlined above, even if a crop and/or machinery lien would be adequate. This will exacerbate the difficulties of beginning and reentering farmers and make it especially difficult for a farmer to progress into obtaining credit elsewhere, one of FmHA's professed objectives. *See* 52 Fed. Reg. 1725 (to be codified at 7 C.F.R. § 1941.2).

Security

While we appreciate FmHA's need to protect the government's interests by requiring adequate security for its loans, the proposed amendments regarding security, 52 Fed. Reg. 1727 (to be codified at 7 C.F.R. § 1941.19), go much too far. The current regulation requires sufficient security "to assure repayment of the loan." The current regulation also limits the agency's ability to acquire a lien on the applicant's real estate. *See* 7 C.F.R § 1941.19(b) ("Such a lien will be taken only when chattel security is *not* adequate. . . .) [Emphasis in original.]

In contrast, the proposed amendments "require the best lien available on *all assets* owned by the applicant" and "on *all* of the applicant's real estate. . . ." [Emphasis supplied.] It is overreaching for FmHA to take a lien on everything if that is not necessary to secure the loan. Apparently, the agency is concerned about the rapid devaluation of security which has occurred in recent years. However, the solution to this problem is to require an adjustment or to foreclose early in the devaluation, not to erect a credit barrier to beginning and reentering farmers. In addition, by taking a lien on all assets, FmHA will thwart its professed objective of enabling farmers to progress to credit elsewhere. *See* 52 Fed. Reg. 1725 (to be codified at 7 C.F.R. § 1941.3).

Loan Approval or Disapproval

Regarding positive cash flow, 52 Fed. Reg. 1727 (to be codified at 7 C.F.R. § 1941.33(b)(1)(iv)), *see* our comments regarding "Planning," *supra*, at p. 7.

Regarding loan risk index, *id.* (to be codified at 7 C.F.R. § 1941.33(b)(1)(viii)), *see* our comments regarding Part 1910, Exhibits A and D, *supra*, at pp. 4-5.

FARM OWNERSHIP LOANS

7 C.F.R. 1943

Positive Cash Flow

Regarding the FO program's cash flow requirements, 52 Fed. Reg. 1728 (to be codified at 7 C.F.R. § 1943.4(o)), *see* our comments regarding "Planning," *supra*, at p. 7.

Credit Elsewhere

Regarding credit elsewhere, 52 Fed. Reg. 1729 (to be codified at 7 C.F.R. § 1943.6), *see* our comments regarding operating loans, *supra*, at pp. 7–8.

Eligibility Requirements

Regarding eligibility requirements, 52 Fed. Reg. 1729 (to be codified at 7 C.F.R. § 1943.12), *see* our comments regarding operating loans, *supra*, at p. 8.

Loan Limitations

Regarding loan limitations, 52 Fed. Reg. 1730 (to be codified at 7 C.F.R. § 1943.17), *see* our comments regarding operating loans, *supra*, at pp. 8–9.

Security

Similarly to the amendments regarding operating loans, the proposed amendments regarding security for farm ownership loans requires FmHA to take a lien on "all assets owned by the applicant." 52 Fed. Reg. 1730 (to be codified at 7 C.F.R. § 1943.19(a)). This requires substantially more than the current regulation which provides for a lien on "the farm," 7 C.F.R. § 1943.19(b), and requires a lien on chattels only in very limited circumstances. 7 C.F.R. § 1943.19(c). As is the case regarding operating loans, requiring a lien beyond that necessary to protect FmHA's security interest is overreaching and thwarts the agency's objective of making it possible for farmers to progress into obtaining credit elsewhere. *See* our comments on operating loans, *supra*, at p. 10.

Loan Approval and Disapproval

Regarding loan approval and disapproval, 52 Fed. Reg. 1731 (to be codified at 7 C.F.R. § 1943.33), *see* our comments regarding operating loans, *supra*, at p. 7.

SOIL AND WATER LOANS

Positive Cash Flow

Regarding the SW program's cash flow requirements, 52 Fed. Reg. 1731 (to be codified at 7 C.F.R. § 1943.54(m)) and 52 Fed. Reg. 1734 (to be codified at 7 C.F.R. § 1943.83(a)(1)(iv)), *see* our comments regarding "Planning," *supra*, at p. 7.

Credit Elsewhere

Regarding credit elsewhere, 52 Fed. Reg. 1732 (to be codified at 7 C.F.R. § 1943.56), *see* our comments regarding operating loans, *supra*, at pp. 7–8.

Loan Approval or Disapproval

Regarding loan approval or disapproval, 52 Fed. Reg. 1734 (to be codified at 7 C.F.R. § 1943.83), *see* comments regarding operating loans, *supra*, at p. 7.

EMERGENCY LOANS

7 C.F.R. 1945

The proposed regulations at 51 Fed. Reg. 1736 and 1737 condition eligibility for an emergency loan (EM) on a finding that there has been a countywide natural disaster. The proposed § 1945.20 states in part:

> EM loans will be made available to applicants having qualifying severe physical and/or production losses *within a county* named by FEMA as eligible for Federal assistance under a major disaster or emergency declaration by the President; or under a natural disaster determination by the Secretary of Agriculture, pursuant to § 1945.6(c)(3)(iii) of this subpart. . . . [Emphasis supplied.]

At 51 Fed. Reg. 1735 a natural disaster is defined as:

> A disaster in any part of the United States in which unusual and adverse weather conditions of other natural phenomena have substantially affected

> farmers by causing severe physical property losses and/or severe production losses within a county.

The Secretary must determine that there has been a reduction countrywide of at least 30 percent of the normal year's dollar value of all crops to find that a county has suffered a natural disaster. It is questionable whether eligibility for an EM loan should be based on whether the farmer is part of a larger disaster area.

The authority for the EM loans is found at 7 U.S.C. § 1961, which states in part that:

> The Secretary shall make and insure loans under this subchapter . . . to (1) established farmers, ranchers, or persons engaged in aquaculture . . . where the Secretary finds that the applicants' farming, ranching, or aquaculture operations have been substantially affected by a natural disaster in the United States . . .

The Congress has not stated any requirement that an applicant be a party of an aggregate disaster area as a condition to receive assistance. In fact, 7 U.S.C. § 1970 concerning eligibility does not contain any requirement similar to that required by the Secretary in the regulations. This statute provides:

> The Secretary shall make financial assistance under this subchapter available to any applicant seeking assistance based on production losses if the applicant shows that a single enterprise which constitutes a basic part of the applicant's farming, ranching or aquaculture operation has sustained at least a 30 per centum loss of normal per acre or a per animal production, or such lesser per centum of loss as the Secretary may determine, as a result of the disaster based upon the average monthly price in effect for the previous year and the applicant otherwise meets the conditions of eligibility prescribed under this subtitle. Such loans shall be made available based upon a per centum, or such greater per centum as the Secretary may determine, of the total calulated production loss sustained by the applicant.

The practice of basing loan eligibility on countywide, rather than individual, crop losses has been subject to earlier criticism. Senator Thomas Eagleton requested an opinion from the Comptroller General on the legality of the Department's countywide eligibility requirement for FmHA emergency loans. The Comptroller General concluded in response to Senator Eagleton that the countywide eligibility requirement is "inconsistent with Congressional intent." *See* Opinion of the Comptroller General, January 10, 1983, at 1. (Attached as Exhibit A.) We have also commented on the requirements of countywide eligibility in regard to regulations purporting to implement the Special Disaster Payments Program, 7 U.S.C. § 1444d(b)(2)(D). *See* Comments On Proposed Rule, 51 Fed. Reg. 18552. As in this case, the Secretary chose to impose countywide eligibility requirements or a program in which the statute contains no such requirement.

Moreover, the imposition of a countywide eligibility requirement makes no sense in the context of disaster loans. As we noted in our earlier Comments, certain types of disasters such as tornadoes and floods do not generally devastate entire counties. The requirement of 30% countywide losses could eliminate those disasters which may be devastating for some farmers and yet do not affect most farmers within a county. Thus, more geographically concentrated disasters are eliminated from the program. If the regulations focused solely on the individual producers' losses and not the countries, this anomalous result could be avoided.

Both as a matter of law and of practice, the countywide eligibility requirements should be eliminated from the proposed rules.

SERVICING AND COLLECTIONS

7 C.F.R. Part 1951

FmHA proposes to delete present § 1951.7(f) which states that county supervisors can call the Finance Office Inquiry Station for various kinds of information such as unpaid balances of accounts being transferred and status of loan checks after two weeks has elasped since the request was submitted. The availability of this information appears to be helpful to county staff and borrowers and we do not understand why it is being deleted.

PROPERTY MANAGEMENT

7 C.F.R. Part 1955

Definition of "Surplus Land" and Sale of Surplus Land

We are very concerned about FmHA's proposals at proposed §§ 1955.53(n), 1955.63(a), 1955.103(n), and 1955.107 to reduce the time period for declaring property surplus from three years after acquisition to one year. We believe these proposed amendments are explicitly prohibited by Congress in 7 U.S.C. § 1985(c) which provides, in part, that:

> Except as provided in subsection (e) of this section, the Secretary may determine whether real property administered under this chapter is suitable for disposition to persons eligible for assistance under the provisions of any law administered by the Farmers Home Administration. Any property which the Secretary determines to be suitable for such purposes shall, whenever practicable, be sold by the Secretary as expeditiously as possible to such eligible persons in a manner consistent with such provisions. *Real property, which is not determined suitable for sale to such eligible persons or which has not been purchased by such persons within a period of three years from the date of acquisition, shall be sold by the Secretary after public notice at public sale* and, if no acceptable bid is received then by negotiated sale, at the best price obtainable for cash or on secured credit without regard to the laws governing the disposition of excess or surplus property of the United States. The terms of such sale shall require an initial downpayment and the remainder of the sales price payable in installments with interest on unpaid balance at the rate determined by the Secretary, but not in any event at rates and terms more favorable than those legally permissible for eligible borrowers. [Emphasis supplied.]

Moreover, in 7 U.S.C. § 1985(e) (added by the Food Security Act of 1985), Congress again emphasized its intention that FmHA sell acquired farmland to family sized farmers, with a special preference to the original owner.

By declaring that all land becomes "surplus" after one year, FmHA's proposed regulations would permit sale by sealed bid or auction to the high bidder after one year rather than permitting sale only to family sized farmers for three years.

In its prefatory comments at p. 1711, FmHA asserts this change is based on a GAO audit recommendation and would allow the agency to move property faster and minimize government costs. However, a GAO audit recommendation does not override the explicit statutory languge of 7 U.S.C. § 1985(c) and 7 U.S.C. § 1985(e). Moveover, had Congress wished to simply save money, it would not have required the three-year period during which FmHA is to seek eligible family farm purchases.

We also object to FmHA's statement at p. 1711 that when property has not been sold after one year, it is due to a lack of eligible buyers. In many states, including North Dakota, FmHA has administratively withheld *all* sales of acquired property for several years because the sale of the property would have depressed farmland values. Almost all of this property would immediately become "surplus" even though it has never been offered for sale by FmHA except possibly to the prior owner. Moreover, FmHA may not have actively pursued sales by appropriate marketing directed at eligible buyers when farmland was available for sale.

In conclusion, the proposed new regulations on "surplus" land should not be adopted because it would entirely thwart congressional objectives in 7 U.S.C. § 1985(c) and 7 U.S.C. § 1985(e) and because it is detrimental to the family farm system of agriculture.

PERSONAL PROPERTY AND REAL PROPERTY

7 C.F.R. Parts 1962 and 1965

The changes in Parts 1962 and 1965, Personal Property and Real Property, incorporate many of the requirements of the *Coleman* v. *Block* decision as well as the recent expressions of intent by Congress by their enactment of the 1985 farm bill. However, certain changes do raise questions about the intent of the changes.

In Section 1962.17(a)(2) there is no provision for what happens when a Form 1962.1 is in the borrower's file and the borrower's request for release is denied. Is there a notice similar to the Form FmHA 1924-14, written explanation of reasons for denial with an opportunity to appeal? (*See* Section 1924.57.)

In 1962.17(b)(1), the five conditions in Form 1962-1, formerly enumerated in the regulations, have been removed. Are those conditions now subject to change without

an opportunity for publication and comment since they are no longer in the regulations?

Section 1962.17(b)(4) adds the words promptly and immediately for notices of the county supervisor by the farmer in case of sales which deviate from the plan in Form 1962-1. Such vague terms do not adequately notify the farmer of his duties under this section. Is interpretation of these terms up to the discretion of the county supervisor or the farmer? (*See* letter of May 23, 1986, pp. 13 and 14, to FmHA from Sarah Vogel for related comments.)

Section 1962.40(b)(3) adds language denying time in addition to the 120 days allowed to a farmer to liquidate voluntarily if there is an agreement with FmHA. This inflexibility would not permit an extension even where a farmer could show a likelihood of bringing more funds in a sale to pay off his loan if the sale were delayed past a busy season for farmers.

REAL ESTATE

7 C.F.R. Part 1965

Release of Proceeds

In Section 1965.13(f)(4)(ii), conditions have been added concerning the use of proceeds when FmHA gives consent by partial release or otherwise to sale, exchange or other disposition of a portion of or interest in security, except leases. One of these conditions is that proceeds will not be used to pay current crop/operating year family living and/or operating expenses. This severely limits a borrower who is seeking sources for payment of these basic necessities in emergency or crisis situations, while FmHA is under no risk since Section 1965.13(f)(4) requires that the loan will be adequately secured.

In Section 1965.25(a), there appears to be a typographical error in the new language which reads, "[F]or the purpose of this paragraph, real estate securing any loan made for real estate purposes is not considered 'additional security' unless it is a tract of land *this* is in addition to the farm real estate." The underlined word "this" should probably be "that."

Appraisals

In Section 1965.26, references are made to appraisals which are to be "completed by an authorized FmHA employee in accordance with Instruction 422.1 (available in any FmHA office)." Outside appraisals are to be done in accordance with Instruction 2024A, also available in any FmHA office. Please see our objections at p. 3, *supra*, to FmHA's deletion of the appraisal regulations from the C.F.R.

Voluntary Liquidation Timing

In Section 1965.26(b) (1) and (2), no discretion is allowed for the extension of time in which to voluntarily liquidate. As with personal property in Section 1962(b) (3) and (4), this lack of flexibility would prohibit a delay even where it could be shown to be economically in the best interest of both FmHA and the borrower, for instance, in the case where a purchaser would not have the necessary financing until beyond the 120 days.

GUARANTEED LOANS

7 C.F.R. § 1980, Subpart B

Surplus Commodity Loan Restrictions

The Attorneys General of the states of North Dakota, Illinois, Iowa, Kansas, Kentucky, Minnesota, Nebraska, Oklahoma, and Wisconsin have previously protested proposed regulations to restrict loans on surplus commodities that were published on December 2, 1985 (50 Fed. Reg. 49395) (*see* Exhibit B). Notwithstanding these comments, on June 19, 1986, FmHA published interim regulations to restrict lending on surplus commodities to the FO, OL, and guaranteed loan programs (51 Fed. Reg. 22273). Now it has again proposed the restrictions on guaranteed loans for financing surplus commodities. *See* proposed § 1980.101(f).

We strongly urge the administrator not to adopt proposed § 1980.101(f) and to retract the parallel provisions of the interim OL and FO regulations found at 7 C.F.R. 1941.17(b) and 7 C.F.R. 1943.17(d) (51 Fed. Reg. 22273, June 19, 1986).

As stated at pp. 1-3 of our attached prior comments, we believe FmHA's attempt to restrict loanmaking on production of surplus crops is in excess of FmHA's statutory authority and is unlawful. Congress has developed an elaborate farm program to control production administered by the A.S.C.S. As stated at pp. 3-4 of our prior

letter, FmHA will be injuring family farmers (its sole clientele) by restricting FmHA loans on surplus commodities. The only beneficiaries of such a restriction would be farmers who obtain credit from other sources who can reap the benefits of the lowered production that would purportedly result from the FmHA loan restrictions.

Proposed § 1980.101(f) and the related interim regulations on FO and OL loans would allow the administrator to declare that a particular commodity is in "surplus" without allowing prior comment on the specific commodity selected. The potential that such a declaration may come at some unannounced time in the future will chill the willingness of other lenders and suppliers to extend credit to FmHA borrowers since they will be unable to rely on the long-term viability of these borrowers.

The definition of "established base" will freeze FmHA borrowers to the *lower* of a 5-year average or the prior two years' production on the operation. This would severely prejudice many farmers who, for example, may have farmed 420 acres for 1982-1985 but farmed 640 acres in 1986-1987. The use of the *lower* of the 5-year or 2-year average would actually force him to scale back an existing operation and jeopardize any financial commitments he may have made in the interim.

The regulation would also appear to apply to land owned by FmHA. If FmHA recovered a farm with a 480 wheat base by voluntary conveyance in the winter of 1985 and was unable to negotiate a rental with the previous owner in 1986, a renter or buyer could finance operating needs for 1987 for only 240 acres. This flies in the face of the congressional admonition in § 1302(c) of the Food Security Act of 1985 that the farmland leasing program "shall not cause any acreage allotment, marketing quota, or acreage base assigned to such property to lapse, terminate, be reduced or *otherwise be adversely affected*." 7 U.S.C. § 1985(e)(8).

Again, we stress that Congress has established elaborate procedures for regulating production of crops and livestock by adoption of very specific laws in various farm bills, most recently in the Food Security Act of 1985. FmHA's attempt to substitute its own program for surplus commodity production controls is not authorized by law.

Positive Cash Flow

FmHA's proposed definition of "positive cash flow" at § 1980.106(b)(17) is overly restrictive. In subdivision (v), FmHA would "usually" require a cash reserve reflecting depreciation on equipment to be replaced. If machinery is depreciated over five years, it is not usually necessary to set aside cash for five years so that the same kind of equipment can be purchased for cash. This, along with the tax reserve, would have the effect of depriving otherwise eligible persons from guaranteed credit.

Preferences

The present regulation contains only a veteran's preference. 7 C.F.R. 1980.108(b). The proposed regulation contains four preferences when there is a "shortage" of funds: (1) presently indebted FmHA borrowers; (2) farmers with dependent families; (3) farmers with necessary implements; *or* (4) farmers with down payments. Because FmHA funding is virtually always in "shortage," we are concerned that the first, third, and fourth preferences would tend to bar beginning farmers and reentry farmers from eligibility. Unlike the emergency loan program which is restricted to established farmers, the OL and FO programs are also to help farmers get started. With the recent precipitous drops in land values and the widespread availability of used machinery, it is now feasible for beginning farmers to purchase or rent land and to obtain necessary equipment to commence a sound farming operation. FmHA should not foster barriers to sound beginning and reentry farmers.

We are also concerned by the lack of specificity in FmHA's use of the word "shortage." In proposed § 1910.6(d), FmHA proposes to refuse to accept applications when a state's allocation of funds is exhausted. We are concerned that FmHA funds will always be deemed in "shortage."

Prohibition of Demand Notes

We support FmHA's proposed prohibition of demand loans by guaranteed creditors in proposed § 1980.109(a)(v). A regular payment schedule is crucial to sound exercise of the guarantee authority and to avoid lender abuse.

County Committee Review

As discussed above at pp. 5–6, we object to any changes in § 1980.115 which would allow county supervisors and state directors to overturn favorable eligibility determinations by county committees.

Balloon Payments

The proposed prohibition of balloon payments and the restriction of unequal payments (except for new enterprises and other limited circumstances) in proposed § 1980.124(b)(9) fails to reflect the reality of many farm enterprises. Lower payments for the first three years may make sense if, for example, the farmer has equipment payments on a separate obligation that last only three years and thereafter cease, thus freeing up more money for subsequent years. Balloon payments should not be barred altogether if the collateral position is adequate.

Defaults by Borrower

No "Attachment 1 to Exhibit D" as discussed in § 1980.145 is printed in the Federal Register; therefore, we cannot comment on the text of the form. However, we believe it is crucial that the county supervisor provide a plain English explanation of all available servicing tools (as printed at 7 C.F.R. § 1980.123) at the same time that this form is mailed.

Variable Rates

FmHA would exempt Farm Credit Services lenders from the requirement in proposed § 1980.175(d)(3) to use a variable rate tied to a base rate formula. Instead of exempting system institutions altogether, FmHA should impose a regulation which parallels subsection 301(b) of the Farm Credit Amendments of 1985, P.L. 99-205. This subsection requires "meaningful and timely" disclosure of interest rates. In the case of an adjustable or variable rate loan, system institutions must disclose:

> "the amount and frequency by which the interest rate can be increased during the term of the loan or, if there are no such limitations, a statement to that effect and the factors (including but not limited to cost of funds, operating expenses and provisions for loan losses) that will be taken into account by the lending institution in determining adjustments to the interest rate . . ."

Need to Rely on Farm Income

We oppose deletion of "need to rely on farm income" as an eligibility standard in § 1980.175(b). This issue is discussed in greater detail below at p. 20 in connection with guaranteed farm ownership eligibility standards.

Training and Management Experience

Proposed § 1980.175(b)(1)(iii) parallels the provisions of proposed § 1941.12(a)(3). Please *see* our discussion, *supra*, at p. 8.

Prior Debts

Proposed § 1980.175(c)(2) would bar any use of a line of credit guarantee to pay debts from prior years' operations. In contrast, loan note guarantees can be used to refinance debt incurred for any authorized operating loan purpose including FmHA insured loans. *See* proposed § 1980.175(c)(1)(iv). We believe both forms of guarantee should permit refinancing of prior operating debts. In many cases, payment of "old" debts to suppliers facilitates the future operation of the farm on an efficient and productive basis. FmHA would still be financially protected because debtors must still meet all the other requirements of the regulations as to the soundness of the proposed loan.

Cash Rent

FmHA proposes to eliminate payment of cash rent in all guaranteed operating loans in § 1980.175(d)(2)(iii). We have already discussed our objection to this restriction, *supra*, at p. 9.

Capital Expenditures

Present § 1980.175(d)(1) prohibits use of guaranteed lines of credit for capital expenditures *except* foundation livestock replacements. Proposed § 1980.175(d)(3) prohibits *all* capital expenditures, presumably including foundation herds. This change could have a very detrimental effect on livestock and dairy operations. As livestock is marketed and as cows are culled, proceeds are usually applied to the debt and a line of credit is used to purchase replacements.

This change makes no economic sense because it will simply result in defaults by livestock operators whose herds are diminished and in exercise of the FmHA guarantee with consequent taxpayer losses.

Guaranteed Farm Ownership Eligibility

Present § 1980.180(c)(iv) imposes a requirement that an eligible farmer must "need to rely on farm income to provide a level of living comparable to that considered reasonably adequate for the area." The present regulation allows off-farm employment subject to a county committee determination that the off-farm job would not interfere with a successful farm operation and is intended to be eliminated or reduced within 3 years. The need to rely on farm income eligibility factor has been removed altogether by the proposed regulation. We oppose the removal of this factor because FmHA should not make loans, especially large guaranteed loans of up to $650,000 to partnerships and farm corporations, if borrowers do not in fact need to rely on farm income. On the other hand, FmHA should recognize the reality that many small farmers cannot reasonably survive without off-farm employment under present economic conditions. FmHA should therefore generally keep the need to rely on farm income standard to prevent abuse but also allow county committees greater flexibility on how long off-farm employment may last if farm income alone is inadequate to provide a reasonable standard of living for the area.

Respectfully submitted,

NICHOLAS J. SPAETH,
Attorney General of North Dakota.

THOMAS J. MILLER,
Attorney General of Iowa.

NEIL F. HARTIGAN,
Attorney General of Illinois.

HUBERT H. HUMPHREY III,
Attorney General of Minnesota.

[Exhibit A]

COMPTROLLER GENERAL OF THE UNITED STATES
Washington, DC, January 10, 1983.

B-197765.

Hon. THOMAS F. EAGLETON,
Ranking Minority Member, Subcommittee on Agriculture, Rural Development, and Related Agencies, Committee on Appropriations, U.S. Senate

DEAR SENATOR EAGLETON: This responds to your letter dated May 25, 1982, requesting our opinion, on whether the Farmers Home Administration (Administration) has been unlawfully limiting the availability of natural disaster emergency loans authorized under the Consolidated Farm and Rural Development Act (7 U.S.C. §§ 1013a, 1921 *et seq.* (1976) (Act)). In your view, the Administration's practice of basing loan eligibility on county-wide, rather than individual, crop losses violates the Act. You asked us to review the loan program's authorizing legislation and advise you as to the legality of the Administration's practice. As explained below, we agree that the Administration is conducting the program in a manner which is inconsistent with Congressional intent and in violation of the Act.

You are concerned that the Administration may be administering the loan program contrary to the letter and intent of the provisions of its authorizing legislation, 7 U.S.C. §§ 1961 *et seq.* (1976). Generally under the program, the Secretary of Agriculture makes and insures loans to established farmers, ranchers, or persons engaged in aquaculture (or United States businesses engaged primarily in farming, ranching or aquaculture) who have suffered production losses as a result of having been affected by a natural disaster or by a major disaster or emergency designated by the President. 7 U.S.C. § 1961(a).

7 U.S.C. § 1970, provides that,

> "[t]he Secretary shall make financial assistance under this subchapter available to any applicant seeking assistance based on production losses if the applicant shows that a single enterprise which constitutes a basic part of the applicants' farming, ranching, or aquaculture operation has sustained at least a 30 per centum loss of normal per acre or per animal production or such lesser per centum of loss as the Secretary may determine as amended by Pub. L. 97-35 § 163, approved August 13, 1981, 95 Stat. 378, as a result of a disaster * * *."

Your understanding is that the Administration denies individual farmers emergency loans unless county-wide losses exceed 30 percent of normal production in cases where more than 25 farmers have been affected by a disaster. (If fewer than

25 farmers sustain losses, applications for assistance are considered by Agriculture on an individual basis.)

In your view, 7 U.S.C. § 1970 directs the Secretary to consider each farmer's crop reduction individually when determining if the 30 percent production loss eligibility requirement has been met in cases where more than 25 farmers are affected. Any applicant meeting the 30 percent test should be considered for a loan regardless of the percentage of crop loss of others in his county, under your reading of section 1970. The Administration's practice, however, prevents individuals farmers from applying for loans where more than 25 farmers in a county are affected even though they have suffered a 30 percent crop reduction if county-wide losses do not average 30 percent.

Upon receiving your inquiry, we asked the Secretary of Agriculture for his comments on the issues you raise. His response indicates that your understanding of the administration's practice is essentially correct, although the Department describes it in a slightly different way. The Administration's procedure when a natural disaster occurs is to determine whether a county has suffered a 30 percent loss, and if so the Secretary designates it as a disaster rerlief area. Upon such designation, the farmers within the county may apply for loans individually. However, farmers not in a designated county may not receive assistance, unless there are fewer than 25 farms in the county which have suffered a 30 percent loss. The area designation procedure is prescribed by regulation. 7 C.F.R. § 1945.20 (1982). A guideline established by the Secretary sets forth the requirements that a designation be made on the basis of county-wide losses.

The Secretary's position is that determination of loan eligibility on a county-wide basis is not contrary to the Consolidated Farm and Rural Development Act. In his view, the Act gives the Secretary sufficient discretion in administering the emergency loan program to allow the Department to use the county designation procedure. 7 U.S.C. § 1961, which provides the Secretary the general authority to conduct the program, states in pertinent part:

> "The Secretary shall make and insure loans under this subchapter * * * to (1) established farmers, ranchers, or persons engaged in aquaculture * * * where the Secretary finds that the applicants' farming, ranching, or aquaculture operations have been substantially affected by a natural disaster in the United States * * *".

We recognize that under the statute the Secretary is accorded a degree of latitude in administering the emergency loan program. However, the Secretary does not have the discretion to establish a procedure, such as making an area designation based on county-wide losses, which systematically excludes those farmers which the Congress intended the program to benefit.

The legislative history of section 1961 indicates that Congress does not intend that the Administration follow an area designation procedure in conducting the natural disaster emergency loan program. Before amendment in 1978, section 1961 specified that the Secretary was required to designate emergency areas and make loans in such areas if he found that a natural disaster had occurred in that area which had substantially affected farming. However, in 1978, Congress amended section 1961 by deleting the area designation requirement. (Public Law No. 95-334, § 118, 92 Stat. 426 approved August 4, 1976.) Congress altered section 1961's language to its current form, quoted above. The provision deleting the requirement was a Senate floor amendment to the Senate's version of the bill which was later enacted as the Agriculture Credit Assistance Act of 1978. Senator Allen, Chairman of the Subcommittee on Agriculture Credit and Rural Electrification offered the amendment, apparently on the recommendation of the Farmers Home Administration. 124 Cong. Rec. S. 12139 (Daily ed. May 2, 1978) (remarks of Sen. Allen). He explained the amendment's purpose as follows:

> "The purpose of this amendment, which contains all the present provisions in section 114, is to give the Secretary of Agriculture greater discretion in making available emergency loans. It will permit the Secretary to adopt revised procedures that would make emergency loans more readily available to farmers, ranchers, and aquaculture operators after the occurrence of a natural disaster, therefore making assistance available to disaster victims on a more timely basis." *Id.* at S. 12139

The explanation of the Conference Committee Chairman, Senator Talmadge, during the Senate's consideration of the conference report also indicates that Congress intended that the Administration determine disaster loan eligibility on an individual basis. Senator Talmadge said:

> "In the past, the emergency loan program could not be put into effect without going through the process of having an entire county declared a disaster, under this bill, the emergency program administered by the Farmers Home Administration can be made available to individual farmers on a case-by-case basis. This is a significant improvement over the existing law." 124 Cong. Rec. S. 21996 (daily ed. July 20, 1978) (remarks of Senator Talmadge).

Further, Representative Jones, chairman of the House of Representatives Agriculture Committee's Subcommittee on Conservation and Credit during the House of Representative's consideration of the conference report stated:

> "Another change which should go a long way to reducing frustrations of farmers and their Congressmen is natural disaster situations. One of the first actions I took as chairman of the Subcommittee on Conservation and Credit was to hold hearings on our emergency programs especially as they were operating under the drought conditions. This bill makes some changes in the FmHA disaster loan program which will make it operate much more effectively.
>
> "The secretarial emergency designation would no longer be required in order to make disaster loans to farmers. Instead emergency loans would be made when the applicant's farming, ranching, or aquaculture operations have been substantially affected by a natural disaster in the United States or by a major disaster. I feel this simplified procedure will end a lot of the problems with this program." 124 Cong. Rec. H 21752 (daily ed. July 20, 1978) (remarks of Rep. Jones).

For other portions of the legislative history of section 1961 which indicate that Congress intended that the Secretary administer the program on an individual basis, see 124 Cong. Rec. H 21749 (daily ed. July 19, 1978) (remarks of Rep. Foley); 124 Cong. Rec. S 21998 (daily ed. July 20, 1978) (staff summary of conference substitute); and the Joint Explanatory Statement of the Committee of Conference, reprinted in the U.S. Code Cong. and Admin. News at 1185, 1186 (1978).

The cited legislative history shows that Congress believed that the disaster loan program would operate more effectively if the area designation requirement was abolished. Accordingly, in light of the legislative history discussed above, it is clear that Congress intended that the Administration stop following the area designation procedure and begin determining disaster loan eligibility on a case-by-case basis after the 1978 amendment to 7 U.S.C. § 1961.

The Secretary contends that notwithstanding this legislative history, the Act gives him sufficient discretion to continue to use the county designation procedure. He reads 7 U.S.C. § 1961 as setting forth the basic eligibility criteria for emergency loans. He contends that 7 U.S.C. § 1989, which authorizes him to make regulations and to prescribe conditions for making loans permits him to "issue regulations necessary to define a natural disaster along with establishing guidelines as to the manner of determining whether or not an area is substantially affected by such a natural disaster." The Secretary acknowledges that under his interpretation of 7 U.S.C. § 1989 he has the discretion to make loans available to individual farmers. He informs us, however, that the Department has concluded that the continued use of the county designation process is necessary for "administrative convenience".

The provisions of 7 U.S.C. § 1961 are mandatory, not permissive; the Secretary may not ignore the section's directives. In *Berends* v. *Butz*, 357 F. Supp. 143, 150 (1973), the Secretary of Agriculture made a similar argument to justify terminating an emergency loan program under the previous version of this Act. The United States District Court for the District of Minnesota stated:

> "'Shall' is mandatory language * * * The language in the statutes and regulations relied on by plaintiffs is not of a permissive nature, but affirmatively directs defendants to perform. Whereas the Secretary may have a great deal of discretion in the administration of emergency loans, he has no license to act in violation of mandatory language of statutory laws or agency regulations." *id.* at 150.

See also *Dubrow* v. *Small Business Administration*, 345 F. Supp. 4 (D. Cal. 1972) where the right to apply for Small Business Administration disaster loans was at issue. The Government contended that under the Disaster Relief Act of 1972, the agency had absolute discretion to determine whether or not to make a loan. The Court stated:

"Whatever the limits on this Court's authority to review denial of an application, they do not preclude judicial review when the SBA has refused to follow its statutory duty to determine whether the loan to a given applicant is necessary or appropriate." *id.* at 8, 9.

Accordingly, as subsection (a) states, if the Secretary finds that an applicant's farming operations, as opposed to designated areas, have been substantially affected by a natural disaster, he must make or insure a loan in accordance with the program's authorizing provisions (assuming available funds and that the Secretary determines that the applicant is otherwise eligible). He may not conduct the program under a policy which systematically excludes individual farmers made eligible for loans by the statute.

In our view, the Secretary's County designation policy could operate to frustrate the Act's clear mandate that all qualified farmers who have suffered the requisite minimum loss of 30 percent be eligible for a disaster loan. However, the Secretary's policy would arbitrarily exclude from consideration, regardless of the extent of his loss, a farmer who happens to live in a county where at least 25 of his fellow farmers are affected by a natural disaster but where the average loss, county-wide, fell a little short of 30 percent.

The guideline the Secretary uses to determine what constitutes a substantial loss is set forth in the 1982 Emergency Operations Handbook for USDA State and County Emergency Boards. Under the guideline, a substantial loss is defined as, "at least 30 percent dollar loss to all cash crops grown in the County during the disaster year." Conceivably, there may be counties where a natural disaster has affected more than 25 farmers, but the county-wide production loss is under 30 percent. Farmers who suffered individual losses greater than the 30 percent prescribed by 7 U.S.C. § 1970 would thus be automatically precluded from applying for loans. A farmer residing in a designated county who has suffered a 30 percent loss could get a loan, while his neighbor residing in a non-designated county, who has suffered a much greater loss could not apply for assistance because the losses in his county, suffered by more than 25 farmers, did not meet the Secretary's guideline.

Accordingly, in our opinion, the Secretary's guideline which provides in effect that he makes his determination to accept applications on whether more than 25 farmers have suffered substantial losses based upon county-wide losses is inconsistent with the legal requirement that he make the program available to all who may qualify. The deficiency could be cured, among other ways, if his policy was to make designations in counties where he found that more than 25 farmers had suffered at least a 30 percent loss instead of requiring a county-wide loss of 30 percent.

In that way the program would be available to all farmers—by county designation in counties where more than 25 farmers have been affected by a natural disaster, and by FmHA State Director authorization in counties where 25 or fewer farmers have been affected.

Sincerely yours,

MILTON J. SOCOLAR
(For the Comptroller General of the United States).

[Exhibit B]

ATTORNEY GENERAL,
STATE OF NORTH DAKOTA,
Bismarck, ND, January 30, 1986.

Re Proposed Rule Changes Published December 2, 1985 to Restrict FmHA Loans for Financing of Commodities That Are In Surplus.

OFFICE OF THE CHIEF,
Directives Management Branch, Farmers Home Administration, USDA, Room 6348, South Agriculture Building, Washington, DC.

GENTLEMEN: The Attorneys General of the States of North Dakota, Illinois, Iowa, Kansas, Kentucky, Minnesota, Nebraska, Oklahoma, and Wisconsin recommend against adoption of a proposed rule which would give the administrator authority to restrict loans to producers of surplus commodities. *See* 50 *Fed. Reg.* 49395 (Dec. 2, 1985).

The proposed regulations would allow restrictions of guaranteed and insured farm ownership (FO) and farm operating loans (OL) where the funds would be used for financing agricultural commodities in surplus. The stated purpose is "to support other Governmental (USDA) actions to reduce production and to strengthen de-

pressed prices." The intended effect is to "reduce production of such [surplus] commodities." 50 *Fed. Reg.* 49395.

The states represented by the attorneys general signing this letter have significant numbers of FmHA borrowers who grow crops and commodities that may be restricted under the proposed regulations.

I. THE PROPOSED REGULATIONS ARE IN EXCESS OF STATUTORY JURISDICTION, AUTHORITY, AND LIMITATIONS AND ARE UNLAWFUL

While Congress has historically sought to control production through other agencies of USDA such as the Commodity Credit Corporation, it has never expressed an intention to use FmHA as a vehicle for control of production or the stabilization of depressed farm prices.

The farm ownership and operating loan programs were established and are intended by Congress to serve one primary goal: to supplement the business needs of high credit risk farmers. *Curry* v. *Block*, 541 F.Supp. 506, 513 (S.D.Ga. 1982); *aff'd* 738 F.2d 1556 (11th Cir. 1984). Regulations adopted by FmHA must be consistent with Congressional intent. *United States* v. *Larionoff*, 431 U.S. 864, 871 (1977).

Congress has stated specific eligibility requirements for farmers who seek loans affected by the proposed regulations: citizenship, sufficient training, and experience for the proposed operation, that the applicant be or will become the owner-operator of "not larger than a family farm" and that the applicant be unable to obtain credit elsewhere. 7 U.S.C. 1922; 7 U.S.C. 1941. The purposes for farm ownership loans include "acquiring, enlarging, or improving farms, including farm buildings, land and water development, use and conservation." 7 U.S.C. 1923. The purposes for farm operating loans include purchasing feed, seed, fertilizer, cash rent, and other supplies. 7 U.S.C. 1942. The statutory authorities for FmHA do not support the use of implementing regulations that would authorize FmHA loanmaking for regulation of prices or production.

A primary statutory purpose of FmHA is to "keep existing farms operating." Legislative history note preceding 7 U.S.C. § 1921.

FmHA, since the days of the Rural Resettlement Administration and the Bankhead-Jones Farm Tenancy Act, has had the primary goal of assisting farm families by providing low cost credit. In *U.S.* v. *Kimbell Foods*, 440 U.S. 715, 735 (1979), the Supreme Court held these loan programs to be "a form of social welfare legislation, primarily designed to assist farmers . . . that cannot obtain funds from private lenders on reasonable terms." *Accord*, *Coleman* v. *Block*, 562 F.Supp. 1353, 1364 (D.N.D. 1983); *Allison* v. *Block*, 723 F.2d 631, 638 (8th Cir. 1983); *Curry* v. *Block*, 541 F.Supp. 506, 514 (1982), aff'd 738 F.2d 1556 (11th Cir. 1984).

We find no authority in FmHA's underlying statutory authority to indicate that the Congress intended to authorize the administrator to "freeze" FmHA credit and thereby destroy family farms based on the sole consideration of whether a particular commodity grown or to be grown by that farmer might be in surplus. On the contrary, Congress has established elaborate and detailed production and price mechanisms in it farm bills. The most recent of these is the Food Security Act of 1985, P.L. 99-198. This law sets detailed loan rates, target prices, and mechanisms for production controls on all major commodities with the goal of making agricultural production "market oriented." While some of the laws affecting FmHA were amended in the Food Security Act of 1985, there is *no* expression of Congressional intent to shift FmHA's historic purposes to price and production regulation. In fact, Congress passed an amendment that requires FmHA to release from its security agreements sufficient funds to pay essential family living and farm operating expense. P.L. 99-198, § 1315. This amendment reemphasizes Congressional adherence to FmHA's historic purposes of improving the economic situation of its borrowers.

A regulation issued without statutory authority is unlawful. 5 U.S.C. § 706(2)(D). The proposed regulation is a classic example of unauthorized regulation. If it were promulgated in final form, it would be challenged in the courts and would be declared void.

II. THE PROPOSED REGULATIONS ARE ARBITRARY AND CAPRICIOUS AND AN ABUSE OF DISCRETION BECAUSE THEY UNJUSTLY DISCRIMINATE AGAINST FAMILY SIZED FARMS

The proposed regulations are directed solely at the two loan programs administered by FmHA that are limited to family sized farms. This regulation does not affect non-FmHA farms which are frequently larger than family sized. The proposed regulation directly injures family farms in contravention of the United States' policy to foster family farms:

Policy of the United States to foster and encourage the family farm system of agriculture in this country

Congress reaffirms the historical policy of the United States to foster and encourage the family farm system of agriculture in this country. Congress believes that the maintenance of the family farm system of agriculture is essential to the social well-being of the Nation and the competitive production of adequate supplies of food and fiber. Congress further believes that any significant expansion of nonfamily owned large-scale corporate farming enterprises will be detrimental to the national welfare. It is neither the policy nor the intent of Congress that agricultural or agriculture-related programs be administered exclusively for family farm operations, but is the policy of the express intent of Congress that no such program be administered in a manner that will place the family farm operation at an unfair economic disadvantage.

7 U.S.C. 2266(a)

III. THE PROPOSED REGULATIONS ARE ARBITRARY AND CAPRICIOUS AND AN ABUSE OF DISCRETION BECAUSE THEY WOULD IRREPARABLY INJURE FMHA BORROWERS WHILE BENEFITTING DEBT-FREE FARMERS AND BORROWERS FROM BANKS AND THE FARM CREDIT SYSTEM

Assuming arguendo that restriction of loans to FmHA borrowers would strengthen depressed prices, the sole beneficiaries would be debt free farmers or borrowers from banks production credit associations, and private farm suppliers.

Farmers Home Administration provides only a portion of short and intermediate term credit to farmers. For example, in the Seventh Farm Credit District which covers the states of Michigan, Minnesota, North Dakota, and Wisconsin, FmHA provides only 20% of short and intermediate term credit to the region's 300,000 farmers and ranchers. The sacrifice of the FmHA borrowers would enrich other farmers and would have a devastating impact on FmHA borrowers. Such a result is so ludicrously contrary to FmHA's statutory goals and objectives that it would be unlawful and void.

IV. THE ADMINISTRATIVE PROCEDURE ACT WOULD BE VIOLATED BY ADMINISTRATIVE DECLARATIONS OF RESTRICTIONS AS TO PARTICULAR COMMODITIES

Various news reports have asserted that the proposed regulations, which potentially cover *all* surplus commodities, are actually aimed at validating prior administrative loan restrictions on dairy production and dairy farm loans which had not been published for notice and comment.

The Administrative Procedures Act requires that interested parties be given adequate notice and opportunity for public comment. "Burying" a proposed rule making on dairy loans inside a rule potentially covering all surplus commodities does not comply with the APA's procedural requirements governing notice and comment procedures for informal rule making.

The purpose of the APA notice and comment procedure is "to allow the agency to benefit from the experience and input of the parties who file comments . . . and to see to it that the agency maintains a flexible and open-minded attitude towards its rules." *Chocolate Manufacturers Association of the United States* v. *Block*, 755 F.2d 1098, 1103 (4th Cir. 1985) citing *National Tour Brokers Association* v. *United States*, 591 F.2d 896, 902 (D.C. Cir. 1978) and *Spartan Radio Casting Company* v. *F.C.C.*, 619 F.2d 314, 321 (4th Cir. 1980).

The content of the proposed rule must be sufficiently specific to provide interested parties an opportunity to comment and participate effectively in the rule-making process. *Chocolate Manufacturers Association* v. *Block*, 755 F.2d at 1104 citing *United States* v. *Allegheny-Ludlum Steel Corporation*, 406 U.S. 742, 758 (1972).

The proposed regulations are potentially applicable to *all* surplus commodities. The regulation would authorize the Administrator to issue ex parte final orders as to particular commodities in his unfettered discretion. We believe this procedure would be an improper avoidance of the APA's notice and comment requirements.

An agency's "concise statement of basis and purpose" must demonstrate that it considered all relevant factors and must articulate a reasonable connection between the facts on record and the resulting policy choice. This means the proposed rule must effectively alert an interested party to the possibility of changes eventually adopted from the comments. *Chocolate Manufacturers Association of the United States* v. *Block*, 755 F.2d 1098 at 1104. The purpose of rules which reflect a departure from previous norms must be clearly set forth and the basis for any proposed change must be justified by the rule-making record. *Secretary of Agriculture* v. *U.S.*, 347 U.S. 645, 653 (1954); *Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual*

Automobile Ins. Co., ——— U.S. ———, 103 S. Ct., 2856, 2874 (1983), *See also* Davis, *Administrative Law Treaties*, Vol. 5, p. 405, 2nd Ed. (1984).

If the news reports are accurate that the proposed rules are aimed particularly at dairy loans, the agency should have published the proposed rule so as to elicit comments from dairy farmers, dairy suppliers, or other parties who will be directly affected by the restriction.

We believe the procedural defects in the publication of the proposed regulations would render any subsequent *ex parte* announcement of a restriction applicable to a particular commodity invalid.

V. ANY LOAN RESTRICTION WOULD BE AN UNCONSTITUTIONAL "TAKING" AS TO EXISTING BORROWERS

When an FmHA borrower obtains his first or subsequent FmHA loan he is generally required to provide his land, machinery, crops, cattle and other farm property to FmHA as collateral.

In its security agreements covering crops and chattels FmHA makes a commitment for continued financing to the farmer so long as the borrower is "eligible" for FmHA loans. The Chattel Security Agreements executed by all operating loan borrowers state:

> Secured party will make or insure future loans or advances to Debtor to enable Debtor to raise or harvest farm crops or raise livestock or other animals, provided funds are available and the Debtor meets all then current requirements imposed by regulations of the Secured party.

Par. J., Form 440-4 N.D. (Rev. 8-9-83)

This clause in the security agreement is a contractual commitment by FmHA. A restriction on loan purposes would not be a valid eligibility requirement as Congress has clearly specified proper eligibility critiera. Valid contractual rights are protected by the Fifth Amendment. "Rights against the United States arising out of the contract with it are protected by the Fifth Amendment." *Lynch* v. *United States*, 292 U.S. 571, 578 (1934). When the United States enters into contracts it incurs rights and responsibilities similar to those of private contracting parties. *Perry* v. *United States*, 294 U.S. 330 at 351-52 (1935). The federal government can abrogate its contracts only when it exercises a paramount governmental power, such as the "War Powers" of the U.S. Constitution.

Art. I, Section 8, cl. 11, 12, 14. *Larionoff* v. *United States*, 553 F.2d. 1167, 1179, *aff'd* 431 U.S. 864 (1977). It cannot abrogate a contractual obligation simply to save money. *Id.*, citing *Lynch* v. *United States*, 292 U.S. at 580.

Financing a farm is a long term commitment. FmHA's own contracts explicitly express its continuing obligation to provide financing to eligible borrowers. Borrowers have made enormous investments of time and money in their farming and ranching operations in reliance on this obligation. They have no other source of credit since they are required to "graduate" if other financing is available. Even one year's denial of an operating loan would topple virtually any FmHA farm and the hopes, dreams, and investments of generations of hard-working people would be lost. Any restriction of loans for surplus commodities would be an unconstitutional taking prohibited by the Fifth Amendment as to existing FmHA borrowers.

For the foregoing reasons, we recommend that the proposed regulation be neither adopted nor implemented.

Sincerely,

NICHOLAS J. SPAETH,
Attorney General of North Dakota.

NEIL HARTIGAN,
Attorney General of Illinois.

ROBERT T. STEPHAN,
Attorney General of Kansas.

HUBERT H. HUMPHREY,
Attorney General of Minnesota.

MICHAEL TURPEN,
Attorney General of Oklahoma.

THOMAS MILLER,
Attorney General of Iowa.

DAVID L. ARMSTRONG,
Attorney General of Kentucky.

ROBERT M. SPIRE,
Attorney General of Nebraska.
BRONSON C. LAFOLLETTE,
Attorney General of Wisconsin.

STATEMENT OF EUGENE SEVERENS, CENTER FOR RURAL AFFAIRS, WALTHILL, NE

My name is Eugene Severens, and I am here representing the Center for Rural Affairs. The Center is a non-profit organization founded by rural Nebraskans in 1973 to investigate and analyze how public policies affect Nebraska's rural economy and the family farm system of agriculture that is the basis of that economy.

Two Stages of the Farm Crisis

There are two stages to the current farm crisis. First, the liquidation stage when excess debt, that simply cannot be paid, must be absorbed. The second stage is the rebuilding stage. Once the excess debt has been wrung out of the system, the economic situation, especially low land prices, will be positioned for rebuilding. We are now poised at the closing of the liquidation stage and the beginning of the rebuilding stage.

If the major policy question of the first stage has been how will this excess debt be absorbed fairly, the major policy question of the rebuilding stage is will family farmers be in a position to take advantage of low land prices to rebuild their farms and restore an efficient family farm agriculture.

The Role of FmHA

These are historic times for federal agriculture credit policies and for the agency, FmHA, delegated with the primary responsibility for implementing these federal programs. FmHA already has considerable authority to help FmHA borrowers, first, reposition themselves during the liquidation stage and, second, provides critical opportunities and financing during the coming rebuilding stage. Unfortunately, this authority is being intentionally avoided.

First, as others are testifying, FmHA is doing little, if anything, to help family farm borrowers reposition themselves short of driving them to Chapter 12 bankruptcy. FmHA has the authority to work out fair and realistic debt settlements that could accord expensive bankruptcy or the unnecessary excesses of foreclosure, but in most cases it refuses. We talk about this in more detail in our February 13th comment on FmHA's proposed regulations. I believe the committee already has access to that comment.

Second, FmHA has the authority to become a principle agent in rebuilding family farms by targeting the distribution of its growing inventory of farmland to rebuilding and beginning family farm operations. The law clearly intended this result, but unfortunately, the evidence suggests that FmHA is intentionally bypassing this policy goal.

Mr. Chairman, how FmHA sells its inventory farmland is critical issue, and I fear we are on the verge of seeing a major public policy thwarted. Our organization has prepared a special preliminary report on this matter which is attached to this testimony. In the remaining time I'd like to go through some of the reports principle points.

Thank you for this opportunity to provide testimony.

ANALYSIS OF SALE OF FMHA INVENTORY FARMLAND: MOST FMHA LAND SALES BYPASS 1985 LAW

(DRAFT REPORT—FEBRUARY 1987)

Summary

Recent FmHA data and interviews with selected state and local FmHA officials show that a disproportionate amount of FmHA's inventory farmland has been found "unsuitable" for program purposes and classified as "surplus" by FmHA officials. This means that this land will not be held in reserve as "suitable" property for priority sale to FmHA-eligible, family-size borrowers as required by laws governing the sale of FmHA inventory farmland. Instead, this "surplus" farmland is now being sold on the open market to the highest bidder with discounts provided for cash buyers. By FmHA's most recent data, 78% of current farmland inventory sales (100% in some important farm states) is being sold to buyers who are ineligible for FmHA loans and therefore outside the scope of the agency's mission. If this were to

continue, and give projections for a doubling of FmHA's inventory, the sale of around 7000 farms (over 2 billion acres) would bypass the congressional scheme which envisions this inventory as an important public resource for rebuilding an efficient family farm agriculture.

The suitable/surplus classification methods and data vary dramatically from state to state and suggest that there is no standardized direction from the national office. The disproportionate amount of "surplus" farmland is suspect, and the local or state justification of the classification decisions (when available) is frequently illogical and probably illegal.

It is not clear who the buyers of these "surplus" farms are, but even buyers are "family farmers," they are, by definition, a completely different class of buyers than those intended by the 1985 farm bill amendment to the law governing FmHA sales of inventory farmland [Consolidated Farm and Rural Development Act (CONACT), Section 335; 7 USC 1985]. Section 335 requires, wherever possible, that inventory property be sold for program purposes to FmHA-eligible, family-size operations. Since FmHA eligibility means that borrowers are unable to get credit elsewhere, this would automatically exclude larger, well-established farm operations. This also means that, when land is reserved and sold as "suitable" property for FmHA-eligible borrowers, it will not have an adverse impact on other land values. "Suitable" property is not on the genera! market but available only to FmHA-eligible borrowers who are, by definition, a whole new set of buyers who would not otherwise be able to consider buying farmland.

There are two adverse effects of selling land as "surplus" even if we assumed the classification schemes were legal. In the short run, the practice is far more likely to have an adverse impact on land values. More importantly, in the long run, the practice denies the congressionally mandated distribution of FmHA-acquired farm and ranch land to new or recovering operations that have the potential to start up or rebuild efficient family farms. This use is consistent, precisely, with the historic mission of the agency, and Congress reaffirmed this public purpose when it explicitly addressed the farmland inventory issue in 1985.

Legal Backdrop: The "Suitable-Surplus" Classification Scheme

In the credit title of the 1985 farm bill (Sec. 1314), Congress recognized the significance of the growth in FmHA's farmland inventory and provided for explicit objectives and financial methods for selling and leasing that inventory land. That law, read in conjunction with an earlier still applicable law, is very clear and can be distilled down to the following:

> If the sale of FmHA inventory farmland will not have a detrimental effect on land values, all inventory farmland that is "suitable" for FmHA loan purposes is to be made available on an installment basis to FmHA-eligible, family-size operators for a three year period. If it has not been sold in three years, it can be sold to the general public as "surplus" property.

1. *"Suitable" for program purposes:* The above statutory framework is based on two subsections of Section 335 of the Consolidated Farm and Rural Development Act. For purposes here, the key phrase in the suitable/surplus determination is found at Section 335(c):

> ". . . the Secretary may determine whether real property administered under this title is suitable for disposition to persons eligible for assistance under the provisions of any law administered by the Farmers Home Administration."

This law applies generically to all FmHA inventory property—farmland as well non-farm property. In the case of farmland, however, the relevant "provisions of any law administered by FmHA" is FmHA's long-standing Farm Ownership (FO) program. Thus, subsection (c) requires that farmland inventory be classified as "suitable" if the land could be used for an FO loan by an FmHA-eligible borrower. By this scheme it becomes "surplus" only after being available for sale (as "suitable" property) for FmHA-eligible borrowers for three years. Almost none of the farmland being classified as "surplus" has been in FmHA inventory the required three years. This means this land is being found, at the offset, "unsuitable" for FO program purposes. The critical question becomes—why? on what grounds?

2. *Presumption of suitability:* Since all farmland which enters FmHA's inventory served as collateral for an FmHA loan purpose, one would expect the general rule to be that most of the land would be suitable with FO purposes. The one major exception to this general rule, might be land that served as collateral for disaster Emergency (EM) or Economic Emergency (EE) loans made to operations larger than

family-size farms. Since a critical requirement of the FO program is that a loan must be limited to farms not larger than family-size and cannot exceed $200,000 in value, EM and EE security property now in FmHA's inventory could have presumably been found "unsuitable" if it was bigger than that needed for a family-size farm or exceeded the $200,000 limit. However, as part of the credit title of the 1985 farm bill, Congress foresaw this particular situation and added as part of new subsection 335(e) a requirement that "the Secretary shall subdivide such [oversize] land into tracts suitable for such operator [of a family-size farm]."

This subdivision authority should eliminate most of these reasons for finding farmland "unsuitable." However, certain real estate collateral might not be as subject to subdivision as is bare ground. Indeed, one state official interviewed gave as an example a large farrow-to-finish hog operation which might be "unsuitable" because it is too large and cannot be subdivided. It is also possible that an earlier EM or EE loan made to a large operation might have included an expensive house built on the farmland serving as collateral. However, one would expect this type of exception to be fairly rare. Nevertheless, as decribed in the next section, large amounts of inventory farmland are being classified and/or sold as "surplus". In some important farm states all the land currently for sale is classed as "surplus".

Another possible reason given by one state official for classifying land as "surplus" was that the high cost of needed conservation practices rendered the land "unsuitable". The problem with this argument is that if conservation practices are required, that requirement would normally be proportionately discounted in the land's sale price. It simply doesn't follow that conservation costs should cause land to be unsuitable for FO program purposes.

The most frequently given reasons for classifying land as unsuitable was the absense of a usable house or buildings. This reason ignores the fact that all FmHA inventory farmland was part of an approved FmHA loan purpose. This reasoning is discussed in more detail below.

FmHA Data: Questionable Classification and Sale of "Surplus" Farmland

Recent FmHA data shows a disproportionate amount of farmland that has been classed as "unsuitable" for FmHA program purposes and, therefore, "surplus". This means that this land can be immediately placed on the open market (if FmHA has determined that it will not depress land values) and not reserved for FmHA-eligible family farmers. Nationally, FmHA data show that, as of December 1986, as much as 35% of FmHA's 5011 inventory farms have been classed as "surplus". More disturbing, the proportion of inventory farms actually being sold is even more heavily "surplus"—71% nationally for sales made the first quarter of FY 1987.

1. *Inventory Classification Data:* The chart below shows the proportion of suitable land in the farmland inventories of the 20 states with the largest FmHA farmland inventories:

CHART 1.—PERCENT OF "SUITABLE" LAND IN TOP 20 INVENTORY STATES

State (ranked by amount of farm inventories)	Total acres	Percent of land classed as "suitable"
1. Missouri	162,527	84
2. South Dakota	110,748	92
3. New Mexico	99,515	31
4. North Dakota	78,507	97
5. Kansas	76,564	56
6. Oklahoma	61,171	81
7. Mississippi	61,164	44
8. Iowa	59,876	95
9. Colorado	58,660	80
10. Minnesota	49,444	77
11. Wisconsin	47,861	57
12. Idaho	47,203	32
13. Nebraska	45,347	75
14. Tennessee	38,680	82
15. California	38,493	70
16. Georgia	36,071	19
17. New York	33,946	30
18. Texas	31,400	96
19. Louisiana	28,900	69

CHART 1.—PERCENT OF "SUITABLE" LAND IN TOP 20 INVENTORY STATES—Continued

State (ranked by amount of farm inventories)	Total acres	Percent of land classed as "suitable"
20. Arkansas	28,077	55
National	1,468,204	65

This chart shows an enormous variation in the suitable/surplus classification of inventory property among the top 20 inventory states, stretching from Georgia with only 19% "suitable" farmland to North Dakota with 97% "suitable". These discrepancies cannot be easily explained by region since the variations are also pronounced among states with similar farm climates and economies. For example, what farming conditions explain why the suitability rate in Kansas and South Dakota and Wisconsin differs by 40 points?

2. *Inventory Sales Data and Reclassification as Surplus:* Recent sales of inventory land show an even more lopsided situation. Our interviews with state and county officials suggest that the classification of inventory farmland is being changed on a regular basis, and that earlier "suitable" land is being reclassified as "surplus" at an accelerating pace. First, the recent sales data:

CHART 2.—PERCENT OF INVENTORY SOLD TO ELIGIBLE BORROWERS

States (which sold 5 or more farms, 10-FY1987)	Number farms sold	Percent sold to eligible borrower
1. Indiana	27	19
2. Arkansas	19	47
3. Georgia	16	25
4. Missouri	14	14
5. Kentucky	13	23
6. Tennessee	12	8
7. Pennsylvania	12	42
8. Florida	11	18
9. Mississippi	8	0
10. Maine	7	14
11. Oregon	6	0
12. Michigan	6	50
13. North Carolina	5	0
14. Ohio	5	0
National	209	29

3. *Interviews Show Wide Acceptance of "Surplus" Reclassification:* Telephone interviews conducted with FmHA local officials from March 3–6, 1987, shows widespread implementation of a movement to reclassify otherwise "suitable" farmland as "surplus" in all but 2 of the nine states contacted. There was general misunderstanding that the "suitable" period was one year not three as though the recent January proposed regulations [52 Fed. Reg. 1706; Jan. 15, 1987] were final. Of course, this particular proposed regulation (1955.53) is highly suspect since the three-year period is a statutory requirement [CONACT, Sec. 335(c)].

When officials were asked for the criteria used in classifying and reclassifying "surplus" inventory, the response typically was that there were no clear-cut standards. One answered that land was classified as surplus if there were "no interest" shown in the land by FmHA-eligible borrowers.

One of the common responses was that the land was not suitable if it had no decent house or adequate buildings. This reason apparently assumes that the buyer has no current home and buildings and that none are available. In most parts of the country, potential FmHA-eligible buyers will have little difficulty matching up a piece of FmHA bareground with other farming assets. One state office cited FmHA Instruction 1943.24 (7 CFR 1943.24) as the authority for finding inventory farmland unsuitable. This instruction, however, is designed to test the suitability of a particular piece of property in relationship to how it fits in with the rest of the borrower's

situation. FmHA routinely makes FO loans for bare ground with no house or buildings. These loans are perfectly "suitable" for program purposes, and there's no reason that the sale of bare ground from FmHA's inventory should be subject to a different test.

Officials in these states assume that FmHA-eligible borrowers have nothing—therefore requiring the inventory farm to have everything (standard housing and a complete set of buildings). This is not only inconsistent with well-established and financially sound practices of building up a farm piece by piece, but it appears to be an attempt to bypass the 3-year period during which land is to be reserved for FmHA-eligible borrowers.

Discussion and Recommendations

The distribution of FmHA's farmland inventory is an event of historic proportions. The sale of large amounts of farmland inventory is a new experience in the history of FmHA and a challenge to those responsible for developing public policy during these critical times. As of December 1986, FmHA's inventory contained over 5000 farms (1.5 million acres). And this is just the beginning. With FmHA resuming adverse actions, we estimate that the amount of land entering the inventory could double. While the size of the inventory is a tragic reminder of the on-going farm crisis, redistribution of the inventory into private hands is a once-in-a-lifetime public policy opportunity. It is, of course, also an enormous administrative responsibility. While Congress saw the public policy opportunity in 1985, the evidence in this preliminary report suggests the agency does not share this view. While the evidence varies from state to state, it appears that the national office will let most states take the path of least resistance—classify the land as "surplus" and get rid of it.

Two things seem clear from the evidence in this preliminary report. First, since some state offices seem prepared to conscientiously implement congressional goals, that means it is possible to have that happen in every state. Second, because the national office is content to let those other states go their own way, Congress needs to seriously consider amending the statutory framework of FmHA's inventory disposition laws to better assure implementation of the public policy goal of using inventory farmland as a strategic resource base for rebuilding an efficient family farm agriculture.

We respectively make the following recommendations:

1. *Classification of "surplus" farmland.*—Legislation needs to be added which can prevent the trumped up classification of otherwise suitable farmland as "surplus." In our final report we suggest specific language.

2. *Special eligibility terms for inventory purchase.*—The sale of FmHA's suitable farmland inventory to eligible borrowers differs from the normal FmHA FO loan making process primarily because there are likely to be several FO eligible applicants for most inventory parcels available. In order to distribute the inventory in accordance with public policy goals and in order to avoid "survival of the fittest" competition, a new set of eligibility standards needs to be established for the distribution of inventory farmland.

Current law (Sec. 335(e)(4)(C), CONACT) provides that if there are two or more qualified applicants for purchasing an inventory parcel, then the county committee shall select the operator "on such basis as the Secreatary may provide by regulation."

Recent FmHA regulations define that "basis" as the applicant with the "greatest chance of success." This standard can be abused and is biased towards more established farmers. It fails to provide explicit consideration of the impact of the limited resource interest rate on an applicant's "chance for success," and the current standard will tend to routinely exclude all partially or totally liquidated farmers from rebuilding their farms by purchase of FmHA inventory farmland.

We recommend that FmHA-eligible applicants for purchase of inventory parcels be divided into three groups in the following order of priority:

(1) former owners and operators;

(2) current or beginning farmers (including reentry farmers) who do not own a modest base of land. This could be defined as a certain percentage (for example 25%) of the median size family farm in the area. In our part of Nebraska that would be about 100 acres,

(3) any other FmHA-eligible applicants planning to expand beyond this modest base up to the median sized family farm.

3. *Selection procedures:* After widespread advertising and initial certification of FmHA FO eligibility for all who are interested in an individual parcel, the following steps should take place:

(1) The county committee should examine all those FO eligible applicants' farm operations to determine which of the operations would most benefit from adding the parcel. If the former owner-operator is not interested, priority 2 candidates (above) would be considered. If no priority 2 candidates are found eligible, then priority 3 applicants would be considered. The county committee's consideration should be designed to determine which of the applicant's operations would be most assisted (viability would be most improved) by the inventory purchase.

(2) The county supervisor would then look at the applicant's operation (including the parcel and its payments) to determine if there is repayment ability.

This preliminary report prepared by: Center for Rural Affairs, P.O. Box 405; Walthill, NE 68067; 402-846-5428.

STATEMENT OF JAMES T. MASSEY AND LYNN A. HAYES, FARMERS' LEGAL ACTION GROUP, INC.

We submit this testimony in response to the Committee's invitation to appear to testify on March 11, 1987.

The Farmers Home Administration exhibits stunning contempt for its historical mission, and continuing disregard of the congressional will and mandate carried in FmHA programs. Proposed regulations published by the agency on January 15, 1987, along with several policy initiatives begun in the early 1980s and intensified in late 1985, threaten fully one-third of all FmHA borrowers with liquidation, and much of rural America with large-scale displacement and depopulation. On behalf of our clients throughout the country, we ask the Senate Agriculture Committee, and Congress as a whole, to take immediate legislative action to stop what can only be termed a radical departure by FmHA from its legal obligations. We respectfully request this Committee to conduct emergency, detailed, oversight hearings to gather direct testimony and evidence of the problems outlined in this summarized testimony.

Farmers' Legal Action Group, Inc. (FLAG) is a nonprofit organization that provides legal education, training and support to farmers and ranchers, their lawyers and advocates, and to public policy makers throughout the country. FLAG attorneys also undertake major, systemic litigation on behalf of farmers and ranchers. Exeutive Director James T. Massey and Attorney Lynn A. Hayes have been counsel to the national class of FmHA borrowers in *Coleman* v. *Lyng* (formerly *Coleman* v. *Block*) since 1985. Massey and FLAG attorney Juliet M. Tomkins also represent more than 10,000 Minnesota FmHA borrowers and over 100,000 Minnesota farmers in *Hedge* v. *Lyng*, a class action challenge to FmHA's implementation of county committee elections required in the 1985 Farm Bill.

FLAG staff attorneys have been assisting FmHA borrowers since 1982. James Massey was involved in the initial preparation of the *Coleman* v. *Block* case. Since 1983, he and Hayes filed a companion case in Minnesota. Since 1983, Massey, Hayes and, in 1986, the remaining FLAG staff have provided education, training and direct legal support to thousands of FmHA borrowers across the country. They have delivered well over 100 lectures, workshops and seminars in over 30 states. Seventy-five such sessions have been held since June 1986, with total attendance of over 4,000 farmers, attorneys and community members. FLAG staff have taken hundreds of telephone calls during this period, and have written numerous books, articles and newsletters. *Farmers' Guide to FmHA*, written and edited by FLAG staff, has sold over 40,000 copies in three editions. FLAG's newsletter, *Farmers' Legal Action Report*, is distributed nationwide.

These combined experiences have generated an abundance of direct observation of FmHA practice and conduct. FLAG staff have learned firsthand from FmHA borrowers, attorneys, advocates, community and church leaders, agricultural, extension agents and others just how FmHA is conducting its business.

It is—sadly—an ugly picture. Since 1981, FmHA has steadily, consciously and systemically ignored, refused to implement, misinterpreted, narrowed or otherwise undermined the programs it is charged with implementing—it has, for financially troubled farmers, become a government collection agency. This development raises a substantial and immediate policy question for this Committee: Should FmHA be returned to its roots as the lender of last resort, charged with assisting rural families and communities to continue a family farm system of agriculture; or should it, indeed, become a collection bureau for largely uncollectable debt, and a major farm liquidator? That choice is crystalized by the January 15, 1987 proposed regulations.

The January 15, 1987 proposed regulations suffer from myriad problems—some legal, some policy-based, some pragmatic. We submit for the record, attached to this

testimony, our formal comments on those regulations. However, to fully understand the comments on those regulations. However, to fully understand the significance and potential impact of these proposed regulations, one must view them as part of a continuum of FmHA policy drift which began in 1981. In August 1978, Congress enacted the FmHA deferral statute which has been the subject of more than a score of federal lawsuits since 1981. Under that statute, the Secretary of Agriculture was authorized to defer loan payments, and forgo foreclosures, when circumstances beyond an FmHA borrower's control made it impossible for him/her to make all scheduled payments to the government without unduly impairing the farm family's standard of living. Secretary Block refused to implement the program; farmers and ranchers sued repeatedly, and the courts unanimously agreed that Congress intended the program to be enacted.

FmHA did not publish deferral regulations to implement the program nationally until November 1, 1985. During the seven-year period from August 1978 through November 1985, tens of thousands of FmHA borrowers went out of business. At the same time FmHA enacted delinquent debts from its borrowers. Since that time, FmHA has sent to nearly 90,000 FmHA borrowers—more than one-third of *all* FmHA borrowers—a series of notices informing them of the government's intent to foreclose on their farms. Buried in complex, contradictory and, at times, nearly incomprehensible language, FmHA has included skimpy information on deferral eligibility and how to apply.

The plaintiffs have mounted new legal challenges to this notice procedure claiming, among other things, that the notice procedure was adopted without compliance with the Administrative Procedure Act, that it is constitutionally inadequate, that it is unreadable to the average FmHA borrower, that it fails to provide the borrower with an adequate method for response, and that it does not comply with the statute or earlier court orders. To date, more than 12,000 of these 90,000 FmHA borrowers' accounts—13 percent—have been accelerated, and the farmer faces liquidation or foreclosure. And, of these 90,000, only 2,700—fewer than 3 percent—have been granted some form of deferral.

These grim statistics result directly from the FmHA policy embodied in the November 1, 1985 and subsequent regulations. In short, most FmHA borrowers are unable to qualify for deferrals because:

1. FmHA refuses to provide borrowers with an adequate notice of the deferral program, how to apply for it or what a borrower must demonstrate to qualify. Despite legislation—and direct evidence—that the agency procedures simply do not work, FmHA continues with a procedural approach designed for failure.

2. FmHA refuses to consider debt restructuring or settlement for continuing borrowers. Only those liquidated, or those who can pay off the government, are considered for any debt settlement.

3. FmHA bases future repayment assessments on the full amount of unrestructured debt—irrespective of appraised value of assets or the borrower's net worth situation. Today's low commodity prices—projected to continue for several years—will not produce a cash flow to service this debt, inflated beyond reason by years of accrued interest at relatively high rates as FmHA stalled the deferral process.

4. FmHA requires all applicants for deferrals to demonstrate a positive cash flow after five years of deferral, without regard for the nature of the borrower's operaton, the circumstances that got the borrower in trouble or the alternatives that might exist. For some borrowers, five years is too short a period—they simply need more time to put their houses back in order. For others, five years is too long—the remaining amortization period on loans after the deferral period crowds payments into such a short period that a positive cash flow cannot be shown. The point is, no single arbitrary time frame is necessary or appropriate to the implementation of the statute.

5. FmHA prohibits change or expansion of the farm operation during the deferral period. This prevents many borrowers from demonstrating a positive cash flow by prohibiting the flexibility that all farmers need to make adjustments to their operations during times of financial stress.

6. FmHA uses "crystal ball" figures for costs and prices which assume the worst and which the agency is completely unable to justify on an objective basis. The figures, taken together, make it virtually impossible for any FmHA borrower to demonstrate a positive cash flow.

7. FmHA evaluates farmers' "actual" production costs and yields during the several years prior to application, without regard for abnormal years of disaster, extremely high costs or low prices.

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These are merely highlights; the regulations and FmHA procedures contain a great number of additional problems that render the deferral program virtually nonexistent.

THE 1985 FARM BILL

In the 1985 Farm Bill (the Food Security Act of 1985), Congress again enacted several amendments to the Consolidated Farm and Rural Development Act that were designed to assist FmHA borrowers to continue farming; to resume farming if their operations were lost through liquidation, foreclosure or bankruptcy; or, at the least, to retain their rural homes and several acres if their farming operations could not be salvaged using other new or existing authority. FmHA, through regulation, instruction and policy, has salvaged these amendments. For all practical purposes, these programs have been rendered unusable or unavailable to most financially troubled FmHA borrowers. The 1985 amendments and FmHA policy restrictions include:

1. *Debt Settlement.*—The Secretary's authority to settle or compromise debt was expanded. Congress recognized that much of the existing delinquent FmHA debt was under- or uncollateralized, and that the government is certain to take a financial loss on that debt. In an effort to minimize the loss to the government, to avoid unnecessary legal proceedings and to head off wholesale displacement and depopulation, Congress acted to allow the Secretary to write off this uncollectable debt without foreclosing on tens of thousands of FmHA borrowers.

The Secretary has turned this authority on its head. FmHA regulation and policy, taken together, require FmHA borrowers to liquidate their farm property or to pay in cash equal to the current value of the collateral securing that debt. Borrowers who could realistically demonstrate a positive cash flow, if the government used this authority as Congress intended, are nonetheless forced to choose between voluntary liquidation, foreclosure or bankruptcy instead. The direct, additional costs of this policy to the government alone—to say nothing of the policy and indirect social costs—make FmHA's position on debt settlement as fiscally impossible as it is devastating to rural families and communities.

Finally, FmHA does not afford a notice of the opportunity for debt settlement, or instructions for applying, at any time during its active relationship with farm borrowers. Those few borrowers who learn of the procedure through their own means are frequently told that it does not exist, that the county supervisor cannot process an application or that they must wait until after they liquidate.

2. *Farmland Leaseback and Homestead Retention.*—Congress enacted these provisions in 1985 to assist farmers to maintain their entire farms through leasebacks or with purchases options, or to retain at least their homes and several acres if loss of the farm operation became inevitable. FmHA has implemented these programs in a manner that defeats their purpose and undermines their utility.

With both programs, FmHA requires the farm family to lose the entire farm—through foreclosure, liquidation, conveyance or bankrupcy—before it will even consider eligiblity for either. Thus, farmers by the thousands who wish to present a viable workout or settlement proposal to the government as an alternative to complete liquidation are not allowed to. Rather, they must take their chances on FmHA's later willingness to approve them for these programs—a chancy business in these hard times rife with hard feelings—or they must play "hard ball" through bankruptcy or other litigation and hope for a settlement or a forced workout.

In neither case is the congressional objective satisfied. FmHA could implement an orderly process of notifying and considering borrowers for these programs as part of the loan servicing process, but it has chosen rather to collect and liquidate—notice of these programs is given only as an afterthought. Farm families who have no operations, no income and absolutely no assets left can scarcely be expected to show the ability to even pay on a lease, let alone demonstrate that they have a viable farming operation, as FmHA requires for the leaseback program. As a result of these limitations, few farmers will ever qualify for either of these 1985 programs.

3. *Appeals.*—In 1985, Congress required FmHA to implement an administrative appeal procedure for borrowers who were affected by FmHA "adverse actions". FmHA has arbitrarily insulated many of its decisions from the appeal process, in direct violation of this provision of the 1985 Farm Bill. Appraisal disputes, denials of debt settlement and determination of lease terms for leaseback applications are but three of these exclusions.

4. *Release of Income.*—Congress learned in 1985 that FmHA intended to repeal its regulations interpreted in *Coleman* v. *Block* to require release of necessary family living and farm operating expenses from borrowers' production proceeds. In short, FmHA sought a further means of "starving" FmHA borrowers off their farms by

choking off funds necessary to basic survival. The Secretary was charged in the statute to determine a scheme of "essential" operating expenses.

The Secretary has refused to adopt regulations defining of properly implementing this section. Despite litigation in *Coleman* and repeated requests from our clients to adopt an objective list of "essentials", the Secretary has left it up to FmHA line staff to determine what expenses are "essential" by defining them as "basic, crucial or indispensable". FmHA personnel, with this skimpy guidance, have denied releases for feed, seed, property taxes, church offertories, medical supplies and treatment, IRS employment taxes, payments to short-term "Main Street" creditors, payments on mortgages or land sale contracts, livestock replacement and literally the entire range of other normally incurred household and farm operating expenses. In spite of this—and with this knowledge—FmHA steadfastly refuses to detail further the requirements of the statute. Farmers are again being starved off their farms.

5. *County Committee Elections.*—Congress required two of the three county committee members to be elected by farmers in the community, rather than allowing all three members to be appointed by the Secretary. The FmHA county committee is crucial; its members make all loan eligibility decisions, and they recommend actions on loan servicing, debt settlement and other procedures. Against a backdrop of political cronyism, race discrimination and systemic manipulation of committee members by FmHA personnel, Congress demanded fairness, accountability and independence in the county committee dealings.

FmHA responded by ruling *all* FmHA borrowers—and their spouses and children—ineligible to serve on the committee. It allowed only five days for nomination—two of which were on a weekend. It failed to publish its election regulations for notice and comment in the Federal Register, and declared that any "politically active" farmers could not run for the office. FmHA failed to post or run in newspapers the required advertisements of the elections in some counties and, in other, its personnel asserted that farm wives not enrolled on ASCS lists were not "farmers". In short, FmHA stripped the county committee election process of any viability by substantively and procedurally blocking an open and fair election. Litigation, first initiated by FLAG, has been filed on these issues in Minnesota, Iowa, and North Carolina.

This overview of FmHA's treatment of the 1985 Farm Bill is not exhaustive; it contains only the most substantial problems.

THE PROPOSED REGULATIONS

Moving on the continuum, we turn to the January 15, 1987 proposed regulations. These regulations—nearly 100 pages of radical revamping of FmHA programs and procedures—contain the nails that will hammer closed the coffin that has been crafted for FmHA borrowers over the earlier years of this continuum. A full and complete copy of our comments is attached to this testimony. The Committee is asked to note that we also join in the comments of the Attorneys General of the States of Minnesota, Iowa, Illinois, and North Dakota, and in the comments of the Center for Rural Affairs of Walthill, Nebraska, all of which have been submitted to this Committee.

The highlights of our concerns are:

1. *Pre-Application Ratios.*—FmHA proposes to assess would-be FmHA applicants with a rigid ratio analysis. This could result in fully one-half of all FmHA borrowers becoming ineligible by definition for future FmHA loans. The proposal violates the 1985 Farm Bill appeal statute by making ratio calculations unappealable. The regulations are contradictory and confusing, and they will create more disruption and chaos in local offices.

2. *Appraisals.*—FmHA seeks to delete its appraisal regulations from the Federal Register. This violates Federal law, and plunges the agency deeper into furtive secrecy certain to heighten borrower disenfranchisement.

3. *Appeals.*—FmHA seeks to preclude from subsequent appeals any FmHA borrower who forgets to bring certain materials—or does not understand what to bring—to loan servicing meetings with county personnel. This proposal violates the appeal provision of the 1985 Farm Bill and will contribute further to borrower hostility and disenfranchisement.

4. *County Committee.*—FmHA proposes to allow its own personnel to "appeal" from favorable county committee certifications. This is not authorized anywhere in the statutes, and is a direct assault on the independence of the committee sought by Congress in the 1985 Farm Bill.

5. *Conservation Easement Program.*—FmHA proposes to consider borrowers for the CEP program only *after* considering other loan servicing options, rather than

with other servicing actions. The proposed regulations do not contain any provisions for adequately notifying borrowers of their right to apply for the CEP.

6. *Planning of Expenses.*—The proposed regulations require expense planning far in advance of what is possible for most farmers, and condition release of sales proceeds on these plans.

7. *Reserves.*—The proposed regulations require borrowers to plan for—and show as expenses—reserves for two years of taxes and adequate "capital reserves". This is simply impossible for many financially troubled FmHA borrowers. (It is also ironic in light of FmHA's refusal to allow release of income for property tax payments.)

8. *Surplus Commodities.*—Contrary to assurances it gave Congress, FmHA seeks to venture into the commodity program business through limitation of its loans. This practice is in excess of its statutory authority and is outside the agency's historical mission.

9. *Disaster Year Data.*—The proposed regulations require FmHA officials to include expenses and production from disaster years, as well as from normal years, in determining the feasibility of FmHA loan applications. This rule will foreclose farmers in whole sections of the county—and whole regions of some states—from being able to qualify for FmHA loans.

10. *No Loan Servicing Notice.*—The proposed regulations do not contain adequate or timely notices of loan servicing options. Borrowers will continue to be held in the dark about their options. Under the proposed regulations, FmHA would stop taking loan applications when funds were unavailable. This would wholly disrupt the "first come, first served" process now in place, and would leave many farmers completely in the dark about their potential options. It would also result in chaos once funds become available.

11. *Set-Offs.*—USDA has begun aggressively using set-offs within the agency to obtain payments on delinquent FmHA loans. Under this procedure, FmHA seizes, for example, advance deficiency payments and applies them directly to borrowers' loan accounts. These set-offs rob many farmers of their last source of living and operating funds, and they are tantamount to a foreclosure by starvation.

13. *Inventory Property.*—The proposed regulations would allow FmHA to classify as "surplus" and dispose of inventory property as "unsuitable" after only one year. This property could then be sold to non-FmHA eligible borrowers. The proposed regulation violates a federal statute that requires a three-year holding period, threatens a premature "dumping" of land that will further depress real estate values, and shifts FmHA's land disposition from its historical clients to larger farmers, speculators or corporate concerns.

These, again, are merely highlights.

In conclusion, we respectfully repeat our request that this Committee hold emergency, detailed, oversight hearings to inquire into FmHA's conduct under its enabling legislation. Time is short—90,000 of FmHA's 270,000 borrowers are at risk. Left unchecked, FmHA shows every indication that its policy direction will continue to be collection—or an attempt at collection—at any price. This is a question for Congress—not the agency—because it goes to the core of FmHA program purposes.

Thank you for the opportunity to appear and testify on behalf of our clients. We stand ready to assist the Committee in any way we can.

FARMERS' LEGAL ACTION GROUP, INC.,
St. Paul, MN, March 6, 1987.

Re Comments on Proposed General Revision of Farmer Program Regulations, 52 Fed. Reg. 1706 (January 15, 1987).

OFFICE OF THE CHIEF,
Directives Management Branch, Farmers Home Administration, USDA, Room 6348, South Agriculture Building, Washington, DC.

DEAR CHIEF: We are submitting these comments on behalf of the plaintiff class in the national class action lawsuit, *Coleman* v. *Lyng.* The class is represented by this firm. Farmers' Legal Action Group, Inc. (FLAG) is a nonprofit organization that represents farmers and ranchers. The attorneys on the FLAG staff have been actively working on FmHA farmer program issues for over four years. During this time, the staff has talked with hundreds of FmHA farmer program borrowers and their attorneys throughout the country.

We strongly object to many features of the proposed general revision of farmer program regulations published on January 15, 1987. A summary of our major concerns follows:

PART 1809—APPRAISALS

The proposed deletion of the appraisal regulations from the Code of Federal Regulations violates federal law. Congress has specifically instructed the Secretary to promulgate rules regarding appraisals. 7 U.S.C.A. § 1985 (Supp. 1986). These rules must be contained in the Code of Federal Regulations.

Although the prefatory comments to the regulations indicate that copies of the appraisal procedures will be available in any FmHA office, this is not sufficient. It is important that farmers and their representatives be able to easily locate all FmHA rules. They should not be required to go beyond the Code of Federal Regulations to find these important rules.

The prefatory comments state only one reason for the removal of these regulations. FmHA proposes to delete these rules because they are "administrative regulations used to instruct FmHA field staff in completing appraisals of farm real estate and leasehold interests". 52 Fed. Reg. 1706. The fact that FmHA considers these regulations "administrative" is not justification for removing them from the Code. Many FmHA regulations contained in the Code are administrative in the sense that they are to act as a guide for field staff.

The regulations themselves state that they prescribe the "policies and procedures" for appraisals of farm property. The regulations include standards as well as procedures, and should therefore be retained in regulatory form.

Appraisal valuation is a key element in obtaining financing during this period of rapid decline in land and equipment values. The appraisal valuation of farm property is often the major issue in loan application denials. Farmers and their representatives should have access, through the Code of Federal Regulations, to the methods and standards used by FmHA to determine appraisal valuations.

If these regulations are deleted from the Code, FmHA will have the ability to change its appraisal policies and procedures without notice to the public. This is improper, especially during the current farm crisis when the public is most interested in making sure that proper appraisal methods are being used by the government's farm lending agency.

PART 1900—APPEALS

Section 1900.55(d). This proposed regulation states that the farmer-borrowers who complete Part I of Form 1924-26 and are found ineligible for servicing relief will be sent Exhibit B-7. Exhibit B-7 appears to give the borrower the option between requesting a meeting with the decisionmaker within 15 days, and requesting a hearing within 30 days. Appeal letters that give both options have been very confusing to borrowers. Borrowers do not know, and the letter does not make clear, whether the borrower will be later notified again of his right to an appeal hearing if he chooses to request a meeting and that meeting is unsuccessful. If the borrower wants both the meeting and the hearing, the letter does not say whether both requests must be made within the time limits listed in the letter.

Of course, it would be absurd to require borrowers to request the appeal hearing at a time before they even attend or receive a decision based upon their informal meeting. As a result of this confusion, borrowers often must seek legal counsel simply to determine how to respond to these form letters. To resolve this problem, two different letters should be sent to the borrower—one giving 15 days to request a meeting, and a second to be sent after the meeting, giving 30 days to request an appeal hearing. This procedure was utilized in the past and should be retained.

Section 1313 of the Food Security Act of 1985, Pub. L. No. 99-198, requires FmHA to give every applicant for or borrower of a loan who has been directly and adversely affected by an FmHA decision a written notice of its decision, and an opportunity for *both* an informal meeting and an appeal hearing.

Exhibit B-7, as a result of its confusing language, discourages farmers from requesting the informal meeting. This meeting is very important in the overall appeal process. It is the only opportunity for the farmer and FmHA to clearly define the issues that will be heard at an appeal hearing. While FmHA offices are required to provide specific reasons for the adverse decisions, in practice the reasons given are often not specific enough to ensure a well-structured appeal hearing. This meeting is also the best opportunity for FmHA and the farmer to negotiate. The intent of the informal meeting, as stated by Congress, is to provide an opportunity to resolve differences and to minimize formal appeals. This purpose is thwarted by the Exhibit B-7 letter, which tends to discourage the use of these meetings.

It appears that the first time a form letter containing the 15- and 30-day timelines was included in the regulations was on February 25, 1986. The February regulations were interim regulations, and do not appear to have been finalized. Before they are

finalized, a procedure for notifying borrowers of their right to informal meetings and appeal hearings should be clarified.

Many of the proposed adverse action letters used to notify applicants of adverse decisions are difficult to read and understand. They should be modified if they are to adequately instruct applicants of their rights. All notices and letters to applicants and borrowers should be written in plain language. They should be designed to effectively communicate to someone with the educational level of the average FmHA borrower or applicant—approximately ten years. As they stand, some of the letters and forms require a graduate level education to comprehend.

Section 1900.55(d) also states, "If the borrower or borrower's representative fail to schedule or attend the conference, the borrower is still entitled to a hearing and will be notified in writing of the hearing date, time and location. Exhibit B-4 (Attachment 1) will be attached to this letter." This implies that it may be the responsibility of the borrower to schedule the conference. The borrower, however, is never notified of this obligation. The regulations should make it clear whose obligation it is to schedule the conference. If it is to be the borrower's obligation, the borrower should be so notified.

Attachment 1 also indicates that the borrower's file will remain in the local office for ten days after the receipt of a request for an appeal hearing, so that the borrower can review the file. However, since new Freedom of Information Act regulations were published on September 10, 1986, many FmHA offices are now telling borrowers that FmHA has ten days to respond to requests to review the file. If this is true under the FOIA regulations, Attachment 1 is misleading. If FmHA has ten days to respond to a request to review the file, the borrower must request to see the file on the day he/she requests the appeal, or the file will be sent to the hearing officer before FmHA is required to respond to the borrower's request. Attachment 1 and the FOIA regulations need to be reconciled. The FOIA regulation should make it clear that the borrower does not have to wait ten days after making a request to review his/her file.

Section 1900.55(e). This proposed regulation would remove the current regulatory language stating that a borrower is entitled to an appeal hearing even if he/she does not bring all of the requested information to the conference. This language should be retained so that a borrower is not denied a due process hearing if some piece of information is not brought to the conference. The exhibit in § 1951.44 contains a lengthy, detailed list of information to be brought to the conference. The satisfactory fulfillment of this request should not be the determining factor of whether a borrower is given the right to an appeal hearing. Some of the information may have already been submitted to the office prior to the conference; some may not be available to the borrower; the borrower may not understnd what is being requested. In any case, denying a hearing for failure to bring the information under such circumstances is a violation of due process and of the appeal statute contained in the Food Security Act of 1985. It also creates an absurd situation: according to the regulations, a borrower who does not attend the meeting at all gets a hearing, while the borrower who attends but does not bring all of the required information does not.

Section 1900 (Exhibit D to Subpart B). The chart detailing the hearing officer for various adverse decisions removes the language requiring the hearing officer to be a person not involved in the original decision. This language remains for some housing loan decisions, but is not contained in the chart for the farmer program loan decisions. The removal of the language implies that a person could act as hearing officer even if he/she had participated in making the original decision. This language should be retained in the chart to clarify that the hearing officers on farmer program loan decisions, no matter what their position with the agency, should not have been involved in any way in the original adverse decision. This is a continuing requirement of *Coleman* v. *Block*, 580 F. Supp. 194 (D.N.D 1984).

PART 1910—RECEIVING AND PROCESSING APPLICATIONS

Section 1910.6(a). This proposed amended subsection establishes a procedure whereby a state director may overrule a county committee decision that is favorable to the borrower or applicant. This procedure is in violation of the intent of Congress in passing § 1311 of the Food Security Act of 1985, Pub. L. No. 99-198, which mandates that two of the three county committee members be elected. One of Congress' stated purposes for requiring such an election was to ensure that there was an independent county committee outside the control of the department. It is clear that the use of this amended procedure is anticipated only in cases involving affirmative eligibility determinations by the county committee.

Legislation found at 7 U.S.C. Part 1983 gives the county committee exclusive authority to determine eligibility involving character, industry, and ability of FmHA

farm program applicants. By statute, this authority lies with county committees, but also by statute their decisions are subject to appeal and review. Apparently, the authors of this proposed change would claim that the right to appeal and review an eligibility determination belongs not only to FmHA applicants, but also to FmHA officials. The legislative history of this statute (H.R. Rep. No. 95-986, 95th Cong., 2nd Sess., "Agricultural Credit Act of 1978", March 19, 1978, p. 3) clearly indicates that the right of appeal and review was created for and is reserved to FmHA applicants who believe that adverse eligibility decisions were improperly made. The right to appeal and review was not created for, nor does it apply to, FmHA officials.

PART 1924—PLANNING

Section 1924.57(c)(5)(i). This proposed regulation is confusing. It states that one of the criteria for a positive cash flow is that the plan show that the borrower will be able to "pay all operating expenses and taxes and have a reserve for any tax liability." This language says that the borrower must show that he/she can pay all taxes, and maintain a reserve for tax liability. It is unclear what is meant by paying all taxes and maintaining a reserve for tax liability. This should be clarified.

One possible reading of this subsection is that it requires planning for the payment of two years' taxes in one year. Most farmers do not, and most FmHA borrowers cannot, develop reserves for tax payments in succeeding years. Tax payments should be treated like other operating expenses and, therefore, special reserve accounts should not be required.

Section 1924.57(c)(5)(iv). This proposed regulation also contains confusing and ambiguous language. The term "reasonable standard of living" should be clarified. This section should also clarify that the "reasonable standard of living" applies to the borrower or farm operator *and his/her family.*

Section 1924.57(c)(5)(v). The language in this section should be clarified. "Essential capital expenditures or improvements" should be defined in more detail. The descriptive language, "usually it is necessary to plan for a capital expenditure reserve which reflects the depreciating value of the property that will have to be replaced", is not sufficient.

Does "reflecting the depreciating value of the property" refer to the amount of depreciation listed on the borrower's tax return? If so, this may be inappropriate. Some farmers may have claimed accelerated depreciation on their tax return. This, however, may not reflect the actual life of the property. Any capital expenditure reserve that might be required *must* be directly related to the actual amount of money the borrower must have available to make necessary purchases during the year of the plan.

This requirement also fails to take into account that FmHA is a lender of last resort. Many FmHA borrowers are in a financial situation that would not allow them to continue to make expensive capital expenditures. Overcoming these financial problems usually includes foregoing almost all capital purchases for a number of years. Insistence on such reserves would ignore the reality of the financial situations of those who are, or will become, FmHA borrowers.

Section 1924.57(d)(1). This subsection requires borrowers to base projected income and expenses on their actual production and financial history for the past five years. This does not account for abnormal variations in a farmer's production resulting from circumstances beyond his/her control, such as weather, diseases, etc. This subsection should exclude such variations from consideration. It also does not take into account changes that the farmer proposes to make in the future to improve his/her production or income levels. It is important, especially during times of financial trouble, for farmers to make as many adjustments as necessary in their operation to improve production and income while reducing expenses. This subsection must make it clear that such adjustments are acceptable, and that the borrower's plan will still be considered feasible if it accurately reflects such needed adjustments.

Language similar to that contained in the proposed revised Form 1962-1 agreement should be included in this subsection of the regulations. In the discussion of the figures based on past income, expense, and production levels, it states, "You do not require a strict averaging of my past income, expense, and production levels when calculating those projections, and may permit adjustments of those averages to reflect unusually low or high yields, income or expenses that I have had in the past due to circumstances beyond my control. In reaching these figures, you will consider planned changes in my operation."

Section 1924.57(d)(2). This subsection requires that "Whenever changes in a borrower's operation occur during the year Form 1962-1 must be revised." The borrow-

er is obligated to notify the FmHA Office of the changes. This subsection should refer to Part 1962, which clarified the borrower's reporting requirements.

This subsection also states that the Farm and Home Plan must be revised if there is a major change in the borrowers operation. The term "major change" should be clarified so that both FmHA employees and borrowers have a better idea when revisions will be required.

Section 1924.57(c)(6). This proposed subsection would create a requirement that each borrower who has given FmHA a security interest in chattels annually develop a new Form 1962-1 60 days prior to the expiration of the existing Form 1962-1. Requiring the completion of this form outside the formal annual review, or yearly loan application process, will unnecessarily burden both local office staff and borrowers. Planning done during the loan application process will often result in the need for a completely different Form 1962-1. These forms should be completed with the annual year-end review for borrowers who will not be applying for new loans, and simultaneously with new loan applications for other borrowers.

Since, according to the regulations, Form 1962-1 and the Farm and Home Plan must be consistent, completing a new form 1962-1 will often mean completing a new Farm and Home Plan. The Farm and Home Plan, however, cannot be completed for the upcoming year until the borrower knows what amount he/she will need for operating.

Section 1924.59(d). This subsection sets out when Form 1924-14 must be sent to borrowers. To make this process effective, notice to borrowers of all of the various programs available should be revised to include a description of the conservation easement, debt settlement, dwelling retention, and farmland leaseback programs. It should also include a more detailed description of the servicing programs already described in the form, including information about eligibility criteria. This is necessary because Form 1924-14 is used in conjunction with the "Notice of Intent to Take Adverse Action". Once borrowers receive the "Notice of Intent to Take Adverse Action", they need enough information to enable them to make an informed decision on whether they should apply for servicing on Form 1924-26, and in order to adequately prepare for any loan servicing conference.

This subsection also provides that if a borrower requests additional information after receiving Form 1924-14, the county supervisor will send Exhibit A of Subpart A of Part 1951, and the price list referred to in § 1924.57(d). Exhibit A of Subpart A of Part 1951 is a wholly inadequate response to such a request from a borrower.

Exhibit A provides no additional information about any of the loan servicing programs, other than the deferral program. It contains no response to a request for more information about reamortization, rescheduling, limited resource interest rates, etc.

The additional information about the deferral program is also wholly inadequate. It does not explain what must be done to attempt voluntary debt adjustment, or what documentation will be required at the conference. This failure has repeatedly caused problems and disputes between local office staff and borrowers at servicing conferences. It does not in any way define "impairment of standard of living", but requires the borrower to prove that his/her standard of living will be impaired. This exhibit also indicates that the borrower must prepare a plan for five years into the future. However, the regulations actually require a plan for six years form the time of the conference—the year after a five-year deferral. It fails to explain why this long-term plan is needed.

This exhibit is also in conflict with the new proposed regulation at § 1924.57, which requires that projections of production levels be based on the past five years of the farmer's history. This exhibit asks for only the past three years of records.

For borrowers to be able to prepare the two Farm and Home Plans required by Exhibit A, they must know what the scheduled FmHA payments for each loan will be if they receive one or more of the servicing options available. Obviously, if the borrower is applying for loan servicing, he/she is in financial trouble. Under such circumstances, the borrower must be given every opportunity to make the necessary adjustments in his/her farming operation to show that there will be enough money available to pay the FmHA debt with the loan servicing. The borrower cannot possibly make these necessary adjustments in the Farm and Home Plan, because he/she is never given the payment schedule to work with. The borrower cannot even attempt to calculate those payments because FmHA has failed to provide him/her with any information about the current interest rates if loans are rescheduled or reamortized. FmHA has not even advised the borrower of the payback period for rescheduled or reamortized loans. Without all of this information, the borrower cannot possibly be prepared to carry his/her regulatory burden of proving eligibility for loan servicing at the servicing conference.

Section 1924.72(b). This subsection again refers to § 1951.33(c) which in turn referes to the Exhibit A commented upon under § 1924.59(d) above.

Section 1951.33(c) lists the material that the county supervisor must have available at the loan servicing conference. This list should include payment schedules for each of the borrower's loans for each of the servicing options available. (This information should have been provided to the borrower before the conference. See comments on § 1924.59(d) above.) If the borrower has not received these figures prior to the conference, they should be given to him/her at the conference. Otherwise, the borrower has no way of determining whether errors in the loan servicing calculations have been made. This information is very important if the borrower asks to appeal any servicing denial. For there to be an appropriate review during the appeal process, these figures must be documented in the file so that there can be a thorough review of the calculations.

Section 1924.72(d). This subsection states that if a borrower checks Part III of Form 1924-26, he/she will be given 60 days to cure the default. However, the subsection fails to establish any procedure for informing the borrower of the amount that must be paid to cure the default. If the default was an unauthorized disposition of security, the borrower may have no idea how much he/she is expected to pay to cure that default, because the Form 1924-25 most likely did not include such a figure. (There is no regulatory or procedural requirement that Form 1924-25 include this amount.)

This section must provide some kind of notice to the borrower regarding the amount that must be paid to cure the default, any procedure available to dispute that amount, and a procedure for scheduling a conference at which the borrower's plan to cure the default will be discussed. Form 1924-25 indicates that such a conference will be held.

Section 1924.72(e). This subsection states that if a borrower checks Part IV of Form 1924-26, he/she must complete the chosen liquidation action within 120 days. This section does not discuss the procedures for accomplishing this action.

FmHA has many regulations that relate to each of the liquidation actions contained in Part IV, including acceptance of conveyance and transfers. The borrower cannot accomplish these things without FmHA input. Consequently, there must be a procedure established to notify the borrower of a conference with the local office, at which the appropriate regulations and procedures will be explained to the borrower so that he/she can accomplish the chosen liquidation action within the required 120 days. The letter to the borrower should also explain what information and documents the borrower must bring to the conference so that the processing of the liquidation action can proceed efficiently. Again, Form 1924-26 indicates that a conference will be held to discuss these matters.

PART 1951—ACCOUNT SERVICING POLICIES

Section 1951.33. Refer to comments contained under § 1924.59(d).

Section 1951.44. This section of the regulations should be clarified to indicate whether the new conservation easement program is to be considered before or after deferral consideration when borrowers apply for deferrals. Under proposed § 1951.40, it appears that borrowers who apply for reamortization, but cannot present a feasible plan, must be considered for conservation easement if it will correct the problem. Since borrowers must be considered for reamortization before they can be granted deferrals on real estate-type loans, it is important to clarify when consideration for conservation easement is to occur in the deferral request processing.

PART 1962—PERSONAL PROPERTY

Section 1962.17(b)(2)(i)(A). This subsection needs to be amended further to clarify what "essential family living and farm operating expenses" include. The terms "basic", "crucial", and "indispensable" in this context are nothing but synonyms for "essential". They provide no further guidance to FmHA staff on what constitutes an essential expense. Section 1315 of the Food Security Act of 1985, Pub. L. No. 99-198, which mandates the release of essential living and operating expenses, places a burden on the Secretary to define these expenses. The Secretary has obviously delegated his authority under the statute to local office staff to make these decisions. In order for this to be a proper delegation of authority, the Secretary must provide substantive guidance to the local office staff regarding what constitutes an "essential expense".

This section should include a substantive list of living and operation expenses that are normally considered "essential". Language similar to the following should be included in this section:

Essential family living and farm operating expenses include but are not limited to the following:

Household operating
Food, including lunches
Clothing and personal care
Health and medical expenses, including medical insurance
House repair and sanitation
School, church, recreation
Personal insurance
Transportation
Furniture
Hired Labor
Machinery repair
Farm building and fence repair
Interest on loans and credit or purchase agreements
Rent on equipment, land, and buildings
Feed for animals
Seed
Fertilizer
Pesticides, herbicides, and spray materials
Farm supplies not included above
Livestock expenses, including medical supplies, artificial insemination, and veterinarian bills
Machinery hire
Fuel and oil
Personal and property tax
Real estate taxes
Water charges
Property insurance
Auto and truck expenses
Utilities payments
Payments on contracts or loans secured by farmland, necessary farm equipment, livestock, or other chattels

The above list was constructed primarily from the living and operating expenses listed on Schedules F and G of the Farm and Home Plan. Including such substantive guidelines will help prevent unnecessary appeals from denials of releases, thus saving much in administrative costs.

Section 1962.17(b)(4). This subsection contains the sentence, "Changes that would result in major change in the borrower's operation will almost always require a visit to the county office so that the county supervisor and the borrower can complete a new Farm and Home Plan and revise Form FmHA 1962-1." The term "major change in the borrower's operation" is vague. The regulations should include substantive guidelines, or at least some examples of types of major changes, so that local office staff have a better idea of when to require an office visit.

This subsection should also indicate that the borrower is not required to determine whether the change in his/her operation is a major change that requires an office visit. This decision should be made by the county supervisor when the borrower calls or writes to report a needed change. [This comment applies also to language contained in § 1962.17(b)(5).]

Section 1962.41(e). The proposed amendment to this subsection provides that if a voluntary sale results in less than full payment of the FmHA debt, the borrower may be released of liability if the county committee has recommended the release. However, there is no procedure established to ensure that the county committee will review for possible release of liability. Such a procedure may be contained in other sections of the regulations. However, those regulations are not cited in this section. There should be a procedure which mandates that the county committee review each voluntary sale situation to determine if release of liability is appropriate. The borrower should be notified of this review.

CONCURRENCE WITH COMMENTS BY THE CENTER FOR RURAL AFFAIRS AND THE ATTORNEYS GENERAL

We have thoroughly reviewed the comments submitted on these proposed regulations by the Center for Rural Affairs dated February 13, 1987, and the comments

submitted by the Attorneys General for the states of North Dakota, Iowa, Illinois, and Minnesota. In addition to the comments submitted above, and with the intent to cut back on duplication of comments, we simply note that we concur with all of the comments submitted by the Center for Rural Affairs and the Attorney General, and that you consider their comments incorporated herein.

Sincerely,

FARMERS' LEGAL ACTION GROUP, INC.,
LYNN A. HAYES, *Attorney at Law.*
JAMES T. MASSEY, *Executive Director.*

STATEMENT OF ALAN BERGMAN, PRESIDENT, NORTH DAKOTA FARMERS UNION

Mr. Chairman. I am Alan Bergman of Jud, North Dakota. I operate a small grains and livestock farm near Jud, and serve as the President of the North Dakota Farmers Union, an organization of family farmers with 31,596 dues-paying members and 55,036 voting members.

With me today, is Karl Limvere, Assistant State Secretary of the North Dakota Farmers Union. For the past number of years he has worked with Farmers Home Administration regulations on behalf of our organization.

Our most immediate concern is that as of this past Friday, our state Farmers Home Administration offices had over $9.7 million in unfunded operating loan applications.

We are in the peak season for processing FmHA loans and it is not uncommon for the state FmHA office to receive in the neighborhood of one million dollars of such applications per day.

The state FmHA office has been out of operating loan funding since February 20, when it used up the allocations for the first two quarters. The first two quarter allocations for instate amounted to $47 million.

The state FmHA office has been requesting the release of the third and fourth quarter operating loan allocations amounting to $15.9 million. While there have been some indications from the Farmers Home Administration's Washington, D.C. offices that funding would be released on a daily basis, as of this past weekend, no additional moneys had been made available.

With applications coming in on a daily basis, and with a backlog of almost $10 million, it is obvious that even the release of the $15.9 million in third and fourth quarter allocations will not cover the need or the demand in our state.

We are deeply concerned that many farmers who had expected FmHA operating loans will not be funded. This occurred last year, when approximately $1.5 million in direct operating loans had been processed, but were never funded because additional allocations were not made.

It should be pointed out that our state has had a history of loan demand exceeding our initial allocations. In FY 1985, North Dakota received an initial allocation for insured operating loans of $57.0 million. It used $168.2 million.

In FY 1986, we also had an initial allocation of $57.0 million for insured operating loans. By the end of the fiscal year, we had used $113 million, and had processed the $1.5 million that went unfunded.

Our FY 1987 allocation for insured operating loans was increased to $63.2 million—however, we have already used $47 million and have unfunded applications of $9.7 million. This leaves $6.5 million left in our full year's allocation. Based on past experience in which insured operating loans have come in at the rate of $1 million per day, it is very likely that within this next week we will have used our initial allocations of insured operating loans for the entire year and will be seeking "pooled" funds.

There is no question in our minds that if additional allocations are made, that there will be additional applications for those funds.

Despite optimistic projections that the farm credit crisis is bottoming out, we believe the need for funding insured operating and ownership loans in our state is increasing, not diminishing.

Based on our recent history in which FmHA insured operating loans have doubled and almost tripled over the allocations, it is our judgment that the real need and demand for FmHA insured operating loans in our state, ranges closer to the $175 to $200 million dollar range.

We have been fortunate in the past number of years in the fact that FmHA in North Dakota has been able to receive national pooled funds to meet some of the additional demand. However, due to the fact that the 1985 Food Security Act begins shifting the allocation of operating loans from insured (direct) loans to guaranteed

loans, we cannot anticipate nor expect that we will be able to again receive the volume of additional pooled allocations that we have in the past.

We believe the whole issue of insured vs guaranteed loans must be reviewed by Congress. We do not believe that guaranteed loans are viable substitutes for the direct loan program.

This shift to guaranteed loans begins to destroy the very purpose of FmHA which is to be the lender of last resort for family-sized farm units.

At best, the guaranteed loan program can only serve a narrow band of farm borrowers: those that can afford the commercial interest rates, but do not have adequate cash flow or collateral to meet the commercial loan standards. In reality, at best, the guaranteed loan program may fit in the range of ten to twenty percent of the borrowers who need FmHA assistance.

We are concerned that the guaranteed loan program does not have the capacity to provide the loan supervision that should be carried out by FmHA in working with a financially distressed producer. Neither the bank nor the FmHA office has adequate personnel to provide that supervision to guaranteed borrowers.

While we do not have recent statistics available, based on the experiences of a few years ago, especially in the emergency disaster loan area, we suspect that the track record of guaranteed loans in terms of loss ratios is just as high, if not higher than direct loans.

Our third concern with guaranteed loans is the amount of bureaucracy that has accompanied these loans. Bankers with whom we have had contact have not been anxious to become involved in the guaranteed loan program, or to process the paperwork of that program. We have attached a letter from the Central Dakota Bank of Jud regarding the number of hours that it took them to process one loan, despite the fact that this bank is an approved FmHA lender.

In many cases, the bank must duplicate many of the procedures that the individual borrower must go through. For example, not only does the borrower have to verify that no funds will be used for production on highly-erodible lands, but the banker must also verify that no loan proceeds will be used on production on highly-erodible lands.

The use of guaranteed loans is not living up to the expectations of the Administration or Congress. For example, in FY 86, North Dakota was allocated $37.8 million in guaranteed operating loans. Despite the pressure that was placed on the use of these funds, North Dakota FmHA offices were only able to utilize $30.8 million of that allocation.

This year (FY 1987), we have been allocated $48.2 million in guaranteed operating loans. The first two quarters had an allocation of $36 million. While every FmHA county office has increased its emphasis on the use of guaranteed loans, as of February 18, only $8.5 million of guaranteed operating loans have been approved and funded.

The simple fact is that for most borrowers, the guaranteed loan is only a postponement of the day of reckoning, and not a means by which they overcome a distressed situation and move back into the commercial loan system. We believe that the guaranteed loan use is already higher than can really be justified in considering the narrow bank of borrowers that guaranteed loans can serve.

Without increased funding for direct loans, the guaranteed loan becomes the only available option by which many farmers can get through the coming year, but, in fact, it is not the solution to their farm credit crisis.

Over the past few years, FmHA subordinations have been much more effective in assisting distressed producers than the guaranteed loan program. This past fiscal year, FmHA in our state subordinated some $80 million in mortgages and liens. This is two and half times the amount that FmHA was able to encourage in the use of guaranteed loans.

Based on the level of subordinations in our state this fiscal year, it can be expected that North Dakota will again be among the top five states in the use of this tool.

It is therefore our recommendation that the 1985 Food Security Act be amended to reverse the shift from direct to guaranteed loans. We believe the authorization should provide that at least eighty percent of the operating and ownership loans be made as direct (insured) loans, and that a maximum of twenty percent of the authorization be made in guaranteed loans.

We would further recommend that the authorization of the 1985 Food Security Act be increased from its current level of $4 billion annually to at least $6 billion annually.

We are deeply concerned that the shift from direct to guaranteed loan programs is the beginning of a phase-out of this vital program. Our experience in the farm

ownership direct loan program is ample evidence that there is a concerted effort to move FmHA out of the direct loan business.

Despite real need for assisting beginning farmers through farm ownership loans, we have seen the allocation for direct ownership loans continue to drop. In FY 1985, the direct ownership loans had an allocation of $14.7 million and North Dakota used $18.9 million in direct FO loans. In FY 1986, that allocation dropped to $8.4 million. We used $8.4 million and we were not able to get further allocations from national pooled funds. For FY 1987, the direct farm ownership loan allocation has dropped to only $1.6 million.

As I stated in our testimony at the Bismarck field hearing last month, our state FmHA office would be better off holding a Reader's Digest-type lottery to find out which dozen farmers in our state will get those farm ownership loans, rather than trying to determine who will get these loans on the basis of need.

As a matter of fact, beginning farmers might have better luck waiting for their Reader's Digest sweepstakes numbers to win than to wait for FmHA funding for farm ownership loans.

Farmers Home Administration is the traditional lender of last resort, and its direct loan authorities are the last available option for farmers in distressed economic times.

We believe one of the best ways to stabilize other farm credit sources, including the Farm Credit System is for the Farmers Home Administration to be fully restored and funded as the lender of last resort.

If the shift to guaranteed loans, the phase-down of direct loans, and the phase-out of FmHA is allowed to continue, we will have destroyed the nation's lender of last resort for this and future generations of producers. There will be no effective way to stabilize our nation's Farm Credit System, our independent bankers and other agricultural lenders.

It appears to us that it is the direction of the Administration to phase-out FmHA and attempt to force the Farm Credit System into the position of being the lender of last resort. If allowed to happen, this will amount to pushing the self-destruct button for that system.

We believe that now is the time for FmHA to aggressively seek opportunities for new farmers and for assisting farmers who have already been forced out of agriculture to get a new foothold in agriculture.

If I were to check out the financial history of the majority of my neighbors, I am sure the most of them got their start with FmHA direct farm ownership and operating loans.

There is no question that land values have come down in my area and in other parts of the state. Some of these land values are at the point that they could cash flow in a realistic farm plan.

Currently Farm Credit Services in the Seventh District is offering foreclosed and forfeited land for sale at drastically reduced interest rates. But, only those who have a substantial down payment and are in a good equity position are able to take advantage of these sales.

This means that the already larger farm operator is getting low-interest money for expansion, while beginning and distressed farm families have no place to turn for financing or refinancing land purchases.

Rural America is being restructured into larger and larger farm units, simply based on the availability of farm credit, and the failure of FmHA programs to provide adequate credit to new farm units.

Ironically, Farm Credit Services (FCS) in the Seventh District is being more liberal with their borrowers than the Farmers Home Administration.

FCS is carrying out a program of restucturing farm debt in which the loan is being written down to the current value of the land and other capital investments of the borrowers. That debt is being set-aside at no interest. If at the end of the loan terms, the value of the assets has remained the same, the debt set-aside, in effect, is forgiven. If, however, the assets appreciate in value, then FCS recaptures the appreciated value by reinstating the loan on the difference between the write-down value and the appreciated value.

This is comparable to the original goals of the FmHA debt set-aside program. Unfortunately, FmHA placed a series of undue restrictions and requirements on the debt set-aside program that made it impractical for many of its borrowers.

If FCS is capable of carrying out a program of debt restructuring, it makes absolutely no sense for FmHA to continue in its present course.

Currently, the only way FmHA borrowers can take advantage of any debt adjustment or real restructuring is if the borrower completely liquidates his farm oper-

ation. In other words, FmHA has the philosophy that in order to save a farmer, they must first destroy the farm operation.

As a practical course, we know that if FmHA liquidates a farmer, either voluntarily or forcibly, FmHA will take significant losses as the value of the mortgages and liens are liquidated down to current values.

It would make much more sense for FmHA to follow the lead of Farm Credit Services and other lenders, either in writing off a portion of the loan or in a debt set-aside (at no interest). The write down or set-aside should be based on the difference between the mortgaged loan value and the current values. If at the end of the loan term, land and other assets appreciate in value, there could be a recapture provision.

We have to remember the original purpose of FmHA as the lender of last resort for family farm agriculture. It should be the goal of FmHA to keep as many farmers on the land as possible. Since a write-down or restructured loan does not involve any new FmHA funds, it would not be a new cost to the government, nor would it require new appropriations.

The simple fact is that our nation's economic and agricultural policies during this past decade has created the massive deflation in agricultural assets. This nation, therefore, has a responsibility to those that are the victims of the devaluation of farm commodities and the inevitable devaluation of farm assets that has followed.

Not only is FmHA continuing in its policies that liquidation is a pre-requisite for any debt adjustment or restructuring, but also, it is our understanding that FmHA has become the "immovable object" when it comes to working with Farm Credit Services in restructuring their loans.

If FCS is willing to write-down and restructure debt for its borrowers, there is no reason for FmHA, as a second lien or mortgage holder to become the stumbling block.

We believe there is adequate authority for FmHA under existing law to restructure and write down loans. We do not believe that new legislation is required. However, we fully recognize that this Department of Agriculture is an unwilling participant and has to be mandated to carry out Congressional intent on such issues.

We believe it has become the policy of this U.S. Department of Agriculture to become the obstructionists in carrying out Congressional intent in efforts to make FmHA programs work for financially distressed farmers. Rather than restructuring farmers, USDA is attempting to restructure American agriculture into larger and larger farm units, without any regard to cost or the damages to the infrastructures of rural America.

Over the years, we have known two types of FmHA officials. One searches through the regulations to find ways to make it possible for a family farmer to get started or to stay on the land. The other searches through the regulations to make it impossible for the family farmer.

Fortunately, the vast majority of county FmHA supervisors and personnel fall into the first category. They are dedicated and committed to family farm agriculture, and are willing to put in thousands of unpaid hours to make it possible for their clients to stay in agriculture.

Unfortunately, the vast majority of those who wish to make it impossible seem to be located in Washington, D.C. and have been given the responsibility of writing the rules and regulations.

Their latest work is the 99 pages of new rules that were published January 15, 1987. It is our recommendation that these rules be immediately and permanently withdrawn.

If USDA refuses to withdraw these regulations, it is our recommendation that Congress override the regulations and deny the use of any FmHA administrative funding for the enforcement of these regulations.

These and previous regulations are examples of the axiom that the big print giveth, and the little print taketh away. Congress has attempted to expand the authority for FmHA to assist FmHA borrowers and family farmers, while FmHA regulators write the little print that takes away the authority and the flexibility of FmHA to carry out it stated objectives.

It appears to us that the purpose of many of these new regulations is to provide the administrative mechanisms by which FmHA can increase its opportunities for the denial of loans and applications.

These regulations reduce the authority of the county committees in determining loan eligibility. They reduce farming options of FmHA borrowers.

We believe these regulations are consistently inconsistent with the intent of Congress to provide farmer-borrowers greater access to FmHA programs, increased

rights and options for borrowers, and a greater role in decision-making for county committees.

Finally, these proposed regulations serve to increase the complexity of FmHA regulations and procedures rather than to simplify these processes.

While we have filed formal responses to these and other regulations, we would like to underscore some of the concerns that we have.

First and foremost, we need FmHA regulations and forms written in simple English, and not "bureaucratize". Borrower rights and options should be written so that we don't have to be a translator and a regulatory codebook and dictionary to figure out what they mean.

Form 1924-26 needs to be revised so that a borrower has the right to receive all servicing options together with liquidation options. Currently, if a borrower has chosen servicing options, he automatically makes himself ineligible for liquidation options, or vice-versa.

We are adamantly opposed to the establishment of a "pre-application" system for FmHA farm program borrowers. The pre-application process not only creates another hoop for the borrower to jump through, but also sidesteps the county FmHA committee in determining eligibility.

Rather than simplifying the process, it creates another level of bureaucracy for both the borrower and the county FmHA offices.

The loan-risk evaluation sheet that will determine eligibility in both the pre-application and application process are what lawyers would normally call "arbitrary and capricious" standards. They are designed to reject applications, rather than to provide a meaningful evaluation of a borrowers capacity to repay the loans. It would almost automatically deny loans to beginning and limited resource borrowers.

The loan risk evaluation sheets and indexes totally ignore the circumstances or the farm plans of a borrower. They do not consider the applicant's past credit history, repayment record, character, or financial management. They do not consider conditions beyond the control of the borrower, such as asset devaluations, crop prices, drought, disease, etc. Congress has specifically required FmHA to consider conditions beyond the control of the individual producer.

These regulations would further erode the authority and the capacity of FmHA county committees. This is in direct conflict with the intent of Congress in moving towards an elected county committee system.

Together with the pre-application process, the regulations propose that FmHA quit taking applications if allocated funds have been used. If such a procedure would be implemented, there would be no record of the level of demand or need for FmHA loans, either for measuring the allocation of pooled funds or for Congressional review in determining appropriations or supplemental appropriations. We believe that FmHA programs have already been grossly underfunded, because many potential applicants have been discouraged from applying by being told there weren't adequate funds available.

The new regulations require "positive cash flows" and additional cash reserves. If FmHA borrowers could meet the additional requirements, they would more than likely be eligible for commercial loans. These additional requirements, essentially are designed to eliminate borrowers, rather than to provide necessary security for FmHA loans.

The standardization on a statewide basis for commodity unit prices, etc. is another unnecessary regulation that is designed to reduce the flexibility of the county FmHA supervisor and committees, rather than to assist borrowers and county offices in processing applications.

While we philosophically agree with crop-share arrangements in which landowners share risks with the producers, we are adamantly opposed to denying operating loans for cash rent. There are too many individual circumstances and conditions which make crop-share arrangements impractical and unavailable. If allowed to take effect, this would become another mechanism for denying loans.

The regulations would deny an operating loan to farmers who have undergone previous debt settlements with FmHA. This denies second-chance opportunities for producers. Under current administrative practices, you cannot undergo debt adjustment without liquidation. Under this regulation, if you have liquidated, the door is now fully closed to you.

The new regulations essentially require that every asset is covered by a lien or a mortgage and be pledged to FmHA, whether or not it is needed to assure payment of the FmHA loan.

Point after point in these regulations, FmHA makes its loan programs more restrictive, and more bureaucratic. Point after point, the flexibility of county supervisors and committees is curtailed.

The final straw in these regulations is the extension of the "surplus crop rule" to FmHA guaranteed loans. The "surplus crop rule" is a time bomb waiting to be dropped as the final assault against FmHA programs. Without any Congressional authority and without any concern for the consequences, FmHA has this rule in its arsenal ready to use whenever the agency wishes to commit suicide.

FmHA was never envisioned or intended to become a crop regulator. As an organization, we have protested again and again that the "surplus crop rule" was an unauthorized extension of bureaucratic authority. Yet, this rule consistently reappears in FmHA regulations.

Not only does FmHA need to permanently withdraw this latest set of regulations, it also needs to backtrack and totally revise some of its previous regulations. A good example would be the permanent withdrawal of Form 1962.1 in which a borrower is required to list the date, the price, and the buyer, of every single bushel or commodity that he plans to sell during the coming year.

This particular form is a bureaucratic headache for both the borrower and for FmHA. It makes FmHA into a secondary bookkeeper and file clerk, rather than supervisor. There is simply no way that a farmer can determine what the market will be or when it will be most advantageous for him to sell a given commodity. Yet, if he doesn't follow the plan exactly, FmHA could take adverse action against him.

In essence, Form 1962.1 and its accompanying regulations means that every time a FmHA borrower sells any commodity that the form will have to be revised and updated. The objective of supervision simply becomes lost in the paperwork. The only useful purpose that this form can serve is to be readily available when, and if, a county supervisor wishes to arbitrarily take adverse action on a borrower.

To be frank, organizations such as ours have been beating their heads against the FmHA walls with almost no consideration of the issues that we have raised about their regulations.

FmHA has consistently brought its regulations forward on a last-minute emergency basis, with little or no time for response, and then proceeded on its pre-determined course. A good example was the interim rules and regulations outlining the election process for FmHA committee members. The entire nominating and election process was shortchanged, and the intent of Congress was to a large extent nullified.

The "surplus crop rule" was another example. Every time we felt that we had assurances that the regulation would be withdrawn and never again see the light of day, it reappeared in another form.

We can draw only one conclusion from the regulations that have been proposed and implemented in recent years; that is, that USDA wants to administratively regulate FmHA out of business. This is not unique to FmHA. We have seen it with other rural programs such as REA and its financing programs.

We would therefore encourage this committee to expand these hearings into a full-scale investigation of the regulatory processes within USDA and FmHA.

Our organization has been a long-time advocate and supporter of the Farmers Home Administration. We believe in the objectives and legislated purposes of FmHA.

Unfortunately, the reputation and credibility of FmHA has been dramatically lowered in the eyes of both farmers and non-farmers. Its regulations have been open invitations to lawsuits. And even successful lawsuits have been consistently sidestepped in regulations and practices.

To put it bluntly, if FmHA were a child, Congress would have legitimate grounds to charge USDA with child abuse.

As a result of the myriad of regulations and the bureaucracy that has been created within the Farmers Home Administration in recent years, our organization, both at the state and national level has called for a total reorganization of the Farmers Home Administration.

Based also on the historical fact that in every serious agricultural crisis, the existing agricutural credit structures were not able to meet the needs of that crisis, we believe it is time for the establishment of a new agency.

This past week at our national convention, we again reaffirmed this call for a new federal agency. With your permission, I would like to outline the combined policies our organization has adopted at the state and national level.

We believe: the ever-increasing debt load in agriculture, in combination with a deteriorating asset base, continued high real interest rates and low commodity prices has reached a critical level of insolvency in agriculture.

Every farm foreclosure and liquidation threatens to collapse the remaining security of the entire agricultural community. Neither the private nor the cooperative farm credit sectors, nor FmHA are capable of meeting this crisis.

Rural American is on a collision course with economic chaos unless immediate action is taken toward massive farm debt adjustment and restructuring.

Since its authorization in 1946, when it replaced the Farm Security Administration, FmHA has been given increasing responsibilities in a wide range of activities for serving rural America. The myriad of responsibilities has made it impossible for the agency to give adequate priority to farm ownership and operating loans. The General Accounting Office has documented the inadequacies of FmHA's responsibility in farm loan supervision. At the same time, Congressional hearings have demonstrated that USDA has been unable to carry out a coordinated rural development program.

Therefore we call for the reorganization of FmHA. Its responsibilities in rural development, such as housing, community facilities, business, industrial, etc. should be consolidated with similar agencies into a Rural Development Administration.

Its farm loan programs should be brought together with additional authorities under a Family Farm Recapitalization Administration.

This new agency must be mandated to provide recapitalization loans to every farm family who needs assistance to begin, to preserve and to maintain their family-sized farm unit.

The recapitalization loan authority should include the authority to make adjustments in the following order:

1. Consolidation, reamortization, or rescheduling of existing loans up to a 40-year loan.
2. Interest rate reduction to the level necessary to achieve repayability.
3. Deferral of as much debt at no interest as may be required until such time as net farm income would permit reinstate of part or all of the deferred debt.
4. Debt adjustment (forgiveness) based on the current valuation of land and capital investments.

Recapitalization loans should be renegotiated every five years to determine if the loan's interest rate, deferral, etc. are appropriate to the needs of the borrower.

The Family Farm Recapitalization Administration should replace the Farmers Home Administration's current farm lending programs and:

1. Be restricted to the assistance of family-sized farm units which cannot obtain financing elsewhere.
2. Provide supervised loan programs.
3. Have authority to provide long-term real estate (farm ownership) and shorter-term production (operating) loans with adjusted interest rates and flexible repayment schedules in accordance with the producer's annual net farm income and crop production.
4. Be authorized to develop innovative programs of finance and assistance for land transfer between generations and for the establishment of new farm units, including programs patterned after the Saskatchewan Land Bank concept.
5. Work closely with state programs designed for beginning farmers and be able to supplement and guarantee such state programs.

The Family Farm Recapitalization Administration should also serve as the primary mechanism for stabilizing private and cooperative farm credit institutions by:

1. Purchasing individual loans of family farmers at a discounted rate from the farm credit sector. Such loans would then be adjusted under the recapitalization loan procedures for the farm family.
2. Issuing bonds to cover part of the face value of mortgages of family-sized operators held by private and cooperative farm credit institutions, thereby providing collateral to secure such loans.
3. Purchasing foreclosed farm units from farm credit institutions for leasing or sale back to the foreclosed family farm operator. Farms and land presently held by FmHA as a result of foreclosure should also be leased, with preference given to the last operator of record if he is known to be of good character, has dealt in good faith with FmHA and other creditors, and can demonstrate repayment ability under a rental arrangement.

The annual lease rate should be based on each year's crop yield and crop price levels. The leases should be five-year terms, renewable by the operator until such time as the lessee can purchase the land.

If the foreclosed farm unit is larger than a family farm or the foreclosed operator does not wish to farm, then it should be redistributed in family-sized units on the lease-purchase basis to beginning farm operators. Recapitalization loans should be available for financing the sale to the lessee.

The Farmers Home Administration should use its existing authorities to the extent possible to achieve the goals of the Family Farm Recapitalization Administration.

A limited moratorium should be established on FmHA foreclosures until the proposed Family Farm Recapitalization programs are instituted.

We are opposed to the phase-down of direct FmHA loans. Guaranteed loans are not a viable substitute for direct loans. We call upon Congress to increase the appropriations and the allocation toward the direct loan programs.

We recognize and understand the immense workload and pressures our county FmHA officials and employees are experiencing. We especially commend those who have remained dedicated to the goals of assisting family farmers in these difficult times.

We call for immediate Congressional hearings for the reorganization of FmHA. We recognize that Congressional efforts are already underway to mandate that FmHA carry out Congressional intent of its existing authority.

FmHA supervisors should understand the program and follow the rules—including submitting applications to the county board for approval.

We have been particularly distressed by the lack of concern shown by the Secretary of Agriculture toward economically distressed agricultural borrowers.

Specifically, FmHA should revoke the provisions forbidding borrowers a right to receive family living and farm operating expenses out of their operations and remove poor agricultural economic conditions as a grounds for debt referral.

The authority for the debt deferral program comes from an act of Congress aimed at providing favorable loans to farmers and ranchers suffering economic loss due to reasons beyond the control of producers. Current regulations render the program useless to the intended recipients because the Administration has purposely limited participation by unrealistic qualification requirements.

We urge FmHA to rewrite the rules and regulations used in implementation of the debt deferral program offered by the Administration. The intent of the program is to provide assistance in saving family farmers and ranchers and should be its first priority.

In essence, at both our state and national conventions, our members and delegates were saying throw the redtape and the regulations out with the bathwater, and let's get back to the original objectives of the Farmers Home Administration.

Frankly, we have come to the point that we believe that it is easier to totally reorganize FmHA, than for Congress to unwind the regulatory maze that USDA and its FmHA administrators have created.

I believe we have reached a point in history, just as occurred when the Farm Resettlement Administration, and later the Farm Security Administration had to be totally reorganized so that they could re-focus on the credit needs of this nation's family farmers.

We commend the Senate Agricultural Committee for conducting this hearing. We are very encouraged that these issues are being brought into the light of day, and we ask that this committee persevere in its efforts to bring FmHA back to it original goals and objectives.

JUD OFFICE,
CENTRAL DAKOTA BANK,
Jud, ND, December 17, 1986.

Subject: FmHA Guarantee Loan Application Procedure.

Mr. ALAN BERGMAN,
President, North Dakota Farmers Union,
Jamestown, ND.

DEAR ALAN: This letter contains documentation of the time which the Central Dakota Bank recently put into a FmHA Guarantee Loan Application. This chronological time frame is from an actual application in which we recorded the time to complete and submit a complete FmHA Guarantee OL Application with an interest buydown request. The Central Dakota Bank is recognized as an Approved Lender by FmHA.

		Hours
August 27–28	Preparation and gather of forms	5
September:		
2	Application for Guarantee completed	1.5
4	Farm Inspection and Chattel Appraisal	4
10	Five Year Production History	3.5
11	Five Year Income and Expense History	2
12	Five Year Income and Expense History	2
16	Cash Flow Projections—1986, 1987	2

		Hours
17	Prepared Interest Buydown Agreement	1
18	Cash Flow Projections, 1988, 1989, 1990	3
19	Cash Flow Projections, 1988, 1989, 1990	1
20	Review of application by bank officers	5
22	Make necessary revisions to application	4
23	Prepared cover letter and loan agreements	9
24	Organized application and made copies	3
26	Presented application to County Supervisor Bank and Borrower present	4
29	Prepared AD-1026 Form as request by County Supervisor	1
October:		
15	County Supervisor requested additional information—met with borrower to gather information	1.5
17	Prepared letter to County Supervisor	1.5
22	Received notification that borrower was found eligible by County Committee for FmHA Guarantee	
27	Received letter from County Supervisor indicating that FmHA could not take favorable action on Guarantee request—letter indicated that decision was basically not appealable.	
30	Responded to denial letter via telephone call	1
31	Reviewed chattel appraisal	2
November:		
5	Revised five year cash flow projections to reflect that plan was workable with FmHA concerns implemented.	3
12	Arranged meeting with FmHA County Supervisor to discuss denial and to negotiate and come to terms on guarantee request. Agreement reached after lengthy discussion.	4.5
13	Made necessary revisions to FmHA Application as requested by County Supervisor and submitted revised application.	4
December 9	Received Conditional Commitment from County Supervisor for FmHA Guarantee Loan and Interest Buydown.	
Total time		68.5

At this time we are working to fulfill the conditions as set forth in the Conditional Commitment from FmHA. Once this is completed a Contract of Guarantee will be issued. After all of the above time has been spent on the application process, a guarantee fee of $800.00 on the chattel line and $320.00 on the line of credit must be sent to FmHA. These fees will be passed on to the bank customer.

Attached is a copy of the contents of an FmHA Application Packet for the customer. It reflects the documents that must be included in a complete application. We feel that this process is too time consuming and unpredictable.

I am also enclosing a copy of the South Dakota State Law which was recently passed which allows bank to write off loan losses over 15 years. Recently Congress passed legislation allowing Farm Credit System 20 years to write off loan losses. Maybe this type of legislation in North Dakota would have some merit in light of the economic situation in the state.

Sincerely,

DAN M. BAUER,
Asst. Cashier—Manager.

Enclosures.

APPLICATION PACKET CONTENTS

1. Cover Letter—Lender Narrative.
2. Request for Loan Guarantee (FmHA Inst 1980-B, Exhibit A, Attachment 3).
3. Request for Interest Rate Buydown (FmHA Inst 1980-B, Exhibit D, Attachment 2).
4. Application for Guaranteed Loan (FHA Form 449-6).
5. Borrower's Current Financial Statement (See FHA Form 449-6).
6. Borrower's Cash Flow Projection—1987 prior to Interest Buydown.
7. Borrower's Cash Flow Projection—1987 after Interest Buydown.
8. Breakdown of Annual Debt Repayment.
9. Borrower's Production Projections in Annual Totals—1987 (Annual Need for Operating Credit—Line of Credit Loan).
10. Chattel Appraisal.
11. Five year history of income & expenses with supporting Federal Income Tax Forms—Schedule F for 1981 through 1985.

12. Five year history of farm production with supporting ASCS 156 Card & ASCS 658 & ASCS 476 for years 1981 through 1985.
13. Five year future Cash Flow projections for 1987, 1988, 1989, 1990, & 1991 without Farm Credit Services restructure proposal.
14. Five year future Cash Flow projections for 1987, 1988, 1989, 1990, & 1991 with Farm Credit Services restructure proposal.
15. Lease Agreements.
16. Lenders Plan for Servicing Loan.
17. Statement Required by Privacy Act (410-9).
18. Request for Statement of Debts and Collateral.
19. Applicant's Eligibility for Guaranteed OL.
20. Statement of Inability to obtain financing without Guarantee.
21. Statement that Items of FmHA Inst. 1980.40 through 1980.45 have been considered.
22. Verification of Non-Farm Income.
23. Credit Report.
24. Form AD-1026 Highly Erodible Land and Wetland Conservation Certification.
25. Loan Agreement/Line of Credit Agreement.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee: We are here today at your invitation to discuss the financial condition of the U.S. Department of Agriculture's (USDA) Farmers Home Administration (FmHA) farm loan portfolio and changes in loan-making policies FmHA has proposed to improve that portfolio. You specifically asked us to provide any information we may have on the proposal's potential impact on FmHA borrower's ability to qualify financially for future farm loans.

Over the past 2 years, we have examined the financial condition of FmHA's farm loan portfolio and its borrowers. In January 1986 we testified before this Committee and released two reports—one providing an overview of FmHA's farmer program debt, delinquencies, and loan losses, and the other analyzing the financial condition of individual FmHA borrowers. These reports portrayed the seriously stressed financial condition of FmHA's farm loan portfolio and its borrowers.

A year later, the story is much the same, despite FmHA's recent efforts to implement new policies to improve the portfolio's condition. About half of FmHA's $28 billion farm loan portfolio remained delinquent as of June 30, 1986. Loan losses continue to escalate, as evidenced by a 275-percent increase between 1984 and 1986. FmHA could potentially lose about $7 billion in outstanding principal on its severely delinquent borrowers, or about one-fourth of its farm loan portfolio. Individual borrower debt load is high. Shrinking equity, annual operating-cash shortfalls, and high debt-to-asset ratios mean that many FmHA borrowers may be headed toward financial failure.

My testimony today will discuss the condition of FmHA's farm loan portfolio and what FmHA has proposed to improve that portfolio. I will also provide the preliminary results of our ongoing review of FmHA loan-making policies and some overall observations.

The financial condition of FmHA's farm loan portfolio

The financial condition of farmers and their lenders has deteriorated rapidly since 1980. As a result, increasing numbers of farmers have been turned down for financing by their private lenders and have come to FmHA for credit assistance.

FmHA has responded to these credit requests by substantially increasing its loan portfolio. Over the 10-year period from 1977 to 1986, FmHA's farm debt in its five major farmer programs—farm ownership, operating, emergency disaster, economic emergency, and soil and water—increased about 370 percent, from about $6 billion to about $28 billion.

In January 1986 we testified before this Committee on the poor financial condition of FmHA's farm loan portfolio as of June 30, 1985. The updated statistics we provide today for the end of June 1986 show some changes, but continue the same bleak picture. Mr. Chairman, I am going to be mentioning quite a few numbers here, and I have a schedule attached to my statement that may be of help in following them. Also attached to my statement are a series of graphs that further illustrate the portfolio's condition.

As you can see from the schedule, the numbers of borrowers and loans are down somewhat, while the amount of outstanding principal increased about $100 million. The number of delinquent borrowers decreased moderately—from about 97,000 to

about 93,000. The amount of delinquent payments rose about $400 million, from $6.4 billion to $6.8 billion, while outstanding principal on delinquent loans still remained about half the total farm loan portfolio. Delinquent amounts and outstanding principal on these delinquent loans would be much higher if FmHA had not made about 18,500 of its delinquent borrowers current in fiscal year 1986 without requiring full loan payments. FmHA accomplished this through servicing actions, such as rescheduling loan terms and deferring loan payments.

The number of severely delinquent borrowers, those who were over 3 years delinquent on one or more loans, decreased slightly between June 1985 and June 1986 but continued to represent a high percentage of total delinquencies at over 36,000 borrowers. Over this same period, the delinquent amount owed by borrowers over 3 years delinquent increased from $4.8 billion to $5.4 billion, while their outstanding principal decreased slightly from $7.0 billion to $6.9 billion. According to FmHA, borrowers over 3 years delinquent probably will not be able to catch up on their payments and most likely will fail.

For the past 10 fiscal years, annual FmHA direct farm loan losses (net of proceeds from sales of loan collateral) grew from $26 million in 1977 to $490 million in 1986. These losses increased about 275 percent between 1984 and 1986, growing from $178 million to $490 million. FmHA estimates that it will write off as losses another $2 billion in the near future.

One of the reasons for the poor condition of FmHA's farm loan portfolio is that, in recent years, FmHA has made some policy decisions that were intended to help farmers stay in business with the hope that the farm economy would improve. One such decision occurred in February 1982 when FmHA instituted a farm loan "continuation policy" that allowed existing borrowers to obtain additional FmHA operating financing without showing the ability to repay existing debt. Although this policy was terminated in November 1985, the effects are still being seen in terms of delinquencies, increasing losses, and many FmHA borrowers overburdened with debt.

FmHA's proposed revision of its farmer program regulations

Given the deteriorated financial condition of its portfolio, FmHA has proposed revising its farmer program regulations to become a more prudent lender while at the same time trying to fulfill its mission as a lender of last resort.

In January 1987 FmHA proposed regulations that, among other things, are intended to help target its resources to only those farmers who have a realistic chance of surviving. To accomplish this, FmHA introduced a credit scoring system to be used in determining a farmer's financial eligibility to participate in its farm loan programs. Prior to this proposal, FmHA based its loan-making decisions on a farmer's cashflow ability. That is, FmHA would have loan applicants estimate their total income and expenses on a farm and home plan. If the estimate showed that the applicant had sufficient revenue to repay expenses, including debt repayment, during the current year, FmHA would approve the loan.

FmHA's proposed credit scoring system would use various financial ratios in addition to cashflow in a two-stage review process to determine a borrower's creditworthiness. In the first, or preapplication, stage the farmer completes a loan application, and the financial information provided on the form is used to compute three financial ratios. These ratios reflect the borrower's debt relative to assets, short-term liquidity, and profitability. An applicant whose financial condition meets the standard set forth in the proposed regulations can continue to the second stage of the process. In the second stage, FmHA uses financial information provided by the applicant on a farm and home plan. The county supervisor must agree with these estimates of the applicant's financial position. This stage involves the recalculation of some of the borrower's financial ratios and also the borrower's repayment ability or cashflow. The county supervisor would be expected to reject any applicant whose preapplication or farm and home plan shows no reasonable prospect for success and a high degree of potential loan failure or risk.

GAO requested to review FmHA loan-making policies

On October 24, 1986, the former Chairman of this Committee requested that GAO review FmHA's loan-making policies to evaluate whether FmHA's financial assistance actually helps family farmers survive rather than increasing their unprofitable debt load and decreasing their equity. After we began our review, FmHA proposed the aforementioned changes in its regulations, including the credit scoring system. We then expanded the scope of our work to assess the impact of the proposed credit scoring system on borrower eligibility.

Before I provide you with the preliminary results of our work, I need to caution you that it is still ongoing and is based on FmHA's January 1987 proposal, which is

currently being revised. We have not evaluated the appropriateness of FmHA's proposed credit scoring system but rather documented its impact on borrower eligibility.

We began our initial work in two FmHA county offices, one in Wisconsin and one in Iowa. We selected these offices because they had relatively high levels of borrowers who received new loans during the first 6 months of 1986. In each office we randomly selected 14 borrowers with 1986 loans for review.

For each borrower we gathered information on the nature and purpose of the 1986 loans, servicing actions on these loans, the borrower's financial condition, and the FmHA county supervisor's opinion about the future financial viability of the borrower's operation. We also asked the county supervisor whether the proposed credit scoring system accurately reflected the borrower's financial position. For each borrower we used the proposed system to determine whether the applicant would have been eligible for an FmHA farm loan on the basis of the financial information estimated in his/her 1986 farm and home plan.

To date our preliminary work indicates that of the 28 borrowers who received new farm loans in 1986, half would not have qualified under FmHA's proposed credit scoring system. These 14 borrowers would be ineligible because the scoring system identifies them as having an unacceptably high level of financial risk. The factors that led to these 14 borrowers being designated as unacceptable risks varied. No single financial ratio eliminates a borrower from eligibility.

Our observations on the financial condition of the 14 borrowers who would not have qualified under FmHA's proposed credit scoring system are as follows:

Two borrowers had farm and home plans that did not show a positive cashflow and, as such, would not have been eligible for loans under FmHA's current loan-making criteria.

Seven of the borrowers were technically insolvent, that is, their total debts exceeded their total assets. In 1986 these borrowers received about $210,000 in additional loan funds and had loans in the amount of about $453,000 serviced for more favorable loan rates and terms.

Twelve of the borrowers with positive cashflows would have negative cashflows without nonfarm income, indicating that these farm operations, by themselves, were not financially viable with the borrowers' current debt loads.

These 14 borrowers, who on average have been with FmHA for just under 6 years, have received about $2.18 million in loans but have not repaid about $1.92 million. This amount of unpaid principal outstanding (88 percent) indicates that the borrowers have made little progress toward freeing themselves from subsidized credit.

Eleven of the 14 borrowers had their equity decline while receiving financial assistance from FmHA.

In addition to analyzing the financial situation of these borrowers, we examined FmHA servicing actions on them and found that 12 of the 14 borrowers had their loans serviced at some point in time. Seven of these borrowers had loans serviced in 1986, six of which were for loans made in 1985, reflecting the rapid deterioration of the borrowers' ability to repay the loans.

Concerning the future financial viability of these farm operations, the FmHA county supervisors responsible for loan-making decisions told us that 7 of the 14 high-risk borrowers would liquidate their farm operations by the end of 1988. In 1986 these seven borrowers received loan funds totaling about $280,000 and had loans serviced in the amount of about $453,000. The borrowers received new 1986 loans because their farm and home plans estimated that they could cashflow for at least one more year.

Finally, for 26 of the 28 borrowers reviewed, county supervisors told us that the proposed credit scoring system generally reflected the borrowers' financial condition. In the other two cases, the county supervisor stated that the proposed system understated the borrowers' financial condition because both borrowers had extensive off-farm income that would not be considered in the preapplication stage and one was also restructuring his debt. Since we completed this preliminary work, FmHA has made plans to revise its credit scoring system to include nonfarm income in the preapplication stage, as well as the second stage. Concerning the restructuring of debt, FmHA has stated that it no longer plans to make loans to borrowers until after debt restructuring actually occurs and the borrower is shown to be an acceptable financial risk.

Mr. Chairman, our review of FmHA's loan making is currently being expanded to four states, and our audit team will be examining FmHA lending actions on a random sample of 160 additional farm borrowers. Our objective is to further document the potential impact of FmHA's revised credit scoring system and determine whether FmHA loan-servicing actions actually help borrowers return to profitabil-

ity or forestall financial failure while increasing the borrowers' debt loads, reducing their equity, and increasing potential future losses to the government.

GAO observations

Our work to date indicates that FmHA's use of a cashflow criterion, by itself, does not assure sound loan-making decisions. Considering only a borrower's estimated ability to cashflow allows loans to be made to borrowers who are already technically insolvent. Generally, these borrowers are so financially stressed that, as the condition of FmHA's portfolio indicates, they end up delinquent and cannot cashflow without FmHA loan-servicing actions. FmHA county supervisors can use extensive loan servicing to make many existing borrowers cashflow "for one more year" and keep the farmers in business. However, the overall financial condition of many of these borrowers is so poor that new loans only increase the farmers' unprofitable debt loads and decrease their equity without long-term prospects for financial viability. Eventually, when all the equity is gone, the farmers can no longer obtain financing and are forced out of business. At this point, the farmers have no remaining assets, and the federal government is often left with loan losses.

Under the law FmHA is to make loans to family farmers who cannot obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms. As such, FmHA provides financial assistance to high-risk borrowers. On the other hand, FmHA is also tasked with using generally accepted sound loan-making practices to ensure that its loans have a reasonable chance of being repaid or that sufficient collateral exists to secure loans if borrowers default.

The proposed credit scoring system, rather than relying solely on cashflow, attempts to ensure that FmHA makes loans only to borrowers who have a reasonable chance of repaying their debt and ultimately having a viable farm operation. As long as FmHA's mission is to be a viable lender and not a grant agency, we agree with the basic thrust of FmHA's efforts to improve its loan-making criteria. We have not fully evaluated the reasonableness or fairness of FmHA's proposed credit scoring system, but the system does attempt to draw the line between those financially troubled farmers who can be helped and those who cannot.

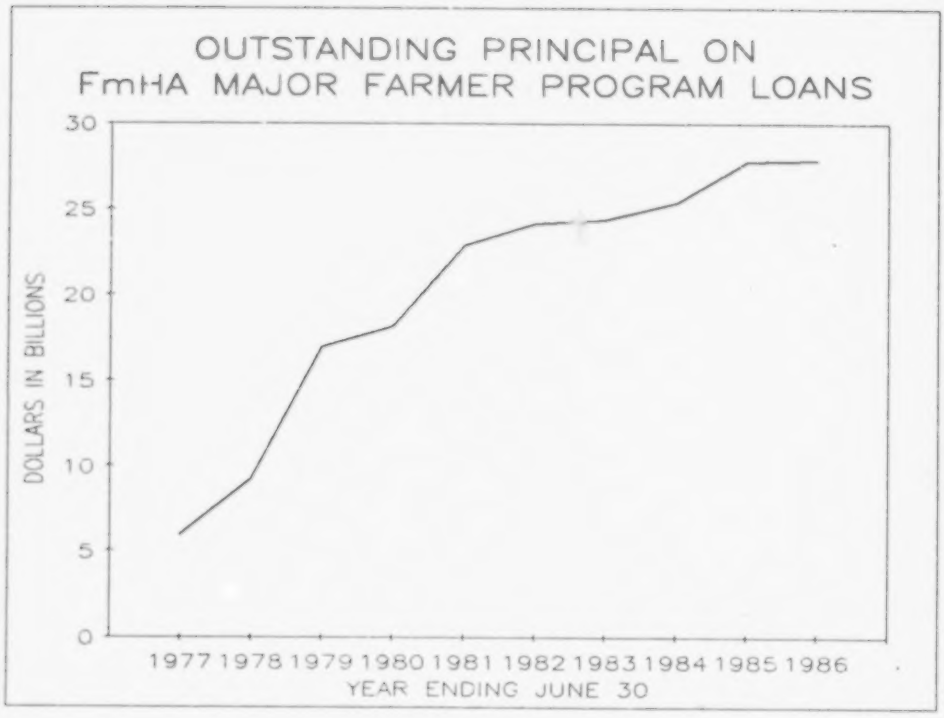
During this difficult economic time for U.S. agriculture, financially weak farm operations are going to fail. We believe FmHA must target its limited resources to those farmers who have the best chance of survival and work toward developing other ways to help those who will not make it.

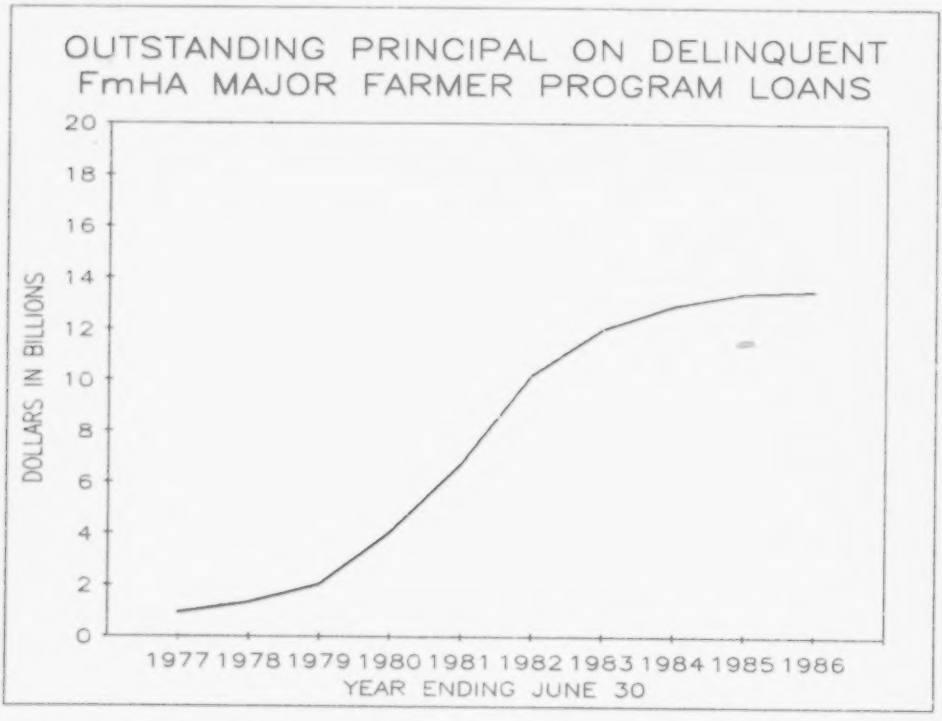
That concludes my statement. We will be glad to respond to any questions.

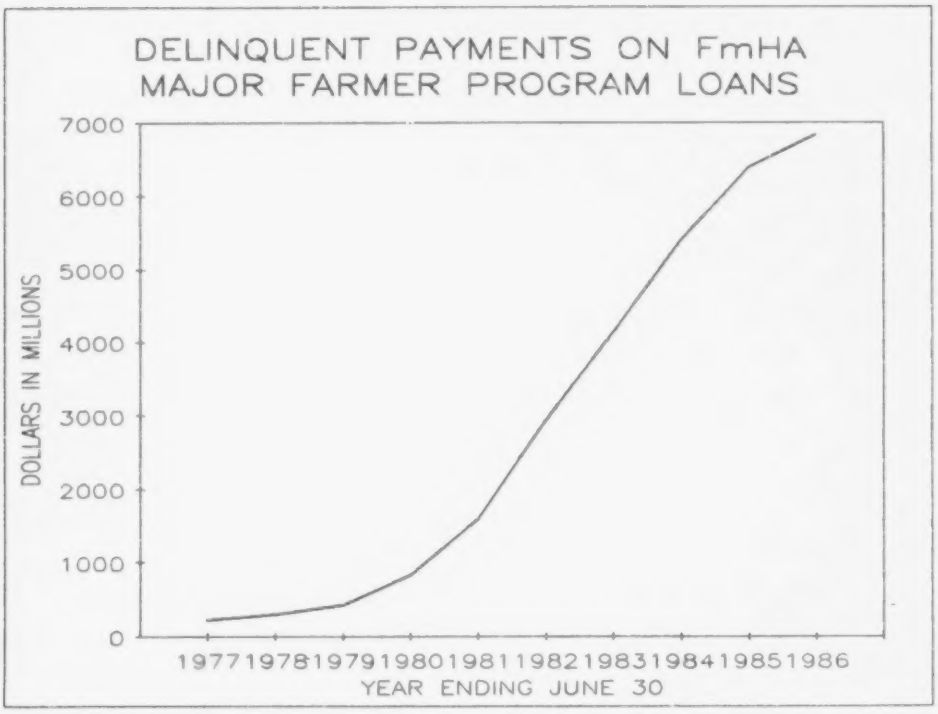
FINANCIAL CONDITION OF FmHA'S FARM LOAN PORTFOLIO, JUNE 30, 1985 TO JUNE 30, 1986

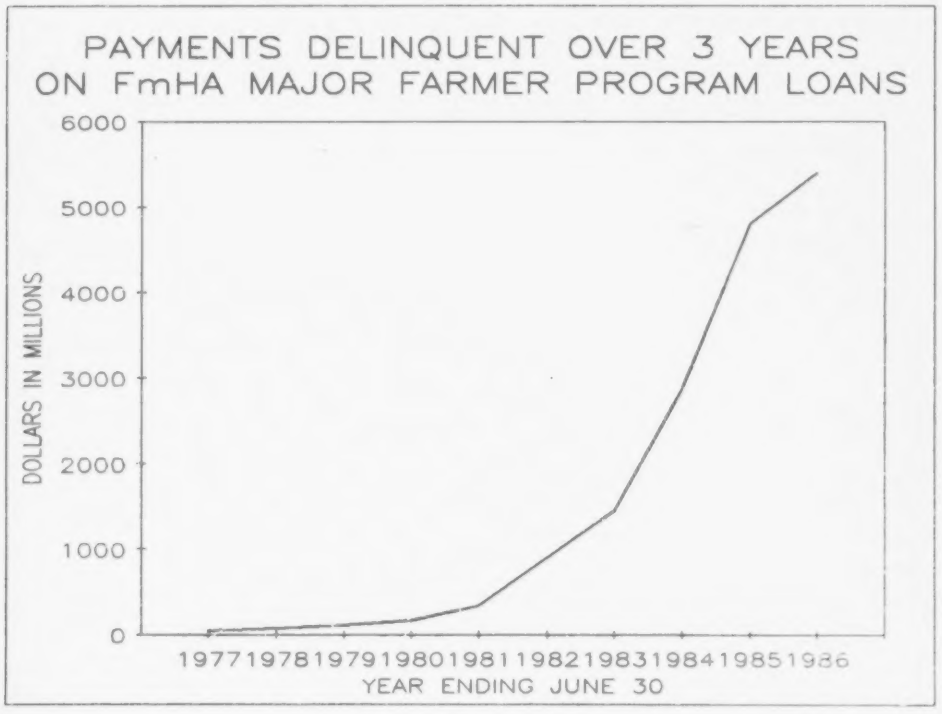
[Dollar amounts in billions]

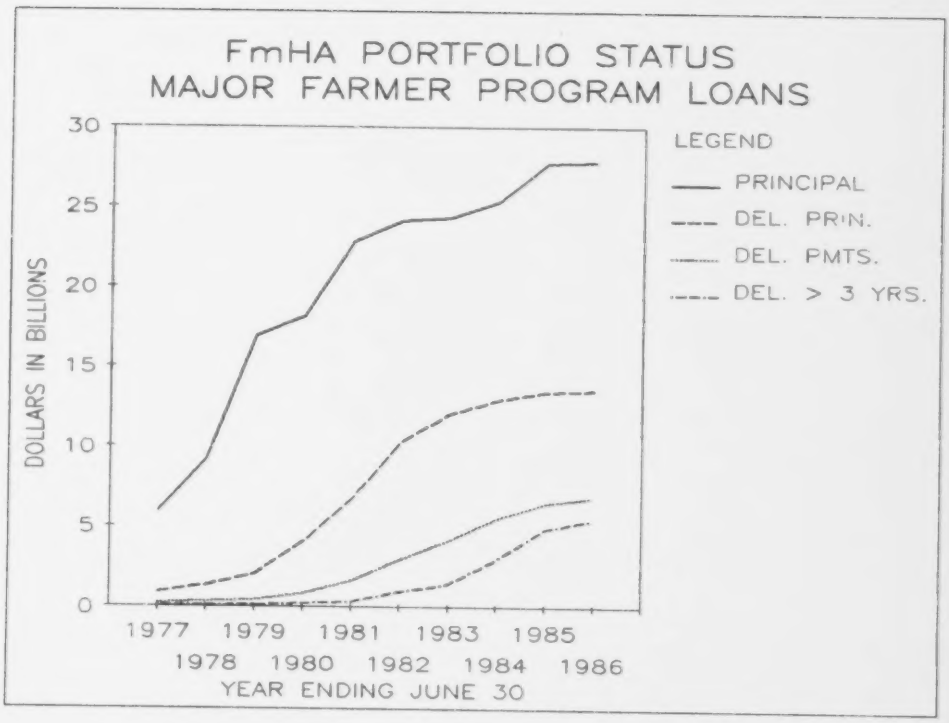
	1985	1986
Number of borrowers	270,058	260,969
Number of loans	757,219	738,737
Outstanding principal	$27.7	$27.8
Number of borrowers delinquent	97,427	92,914
Delinquent loans	344,732	331,369
Delinquent amount	$6.4	$6.8
Outstanding principal on delinquent loans	$13.4	$13.5
Number of borrowers over 3 years delinquent	36,953	36,358
Number of loans owed by borrowers over 3 years delinquent	185,145	177,431
Amount owed by borrowers over 3 years delinquent	$4.8	$5.4
Outstanding principal owed by borrowers over 3 years delinquent	$7.0	$6.9

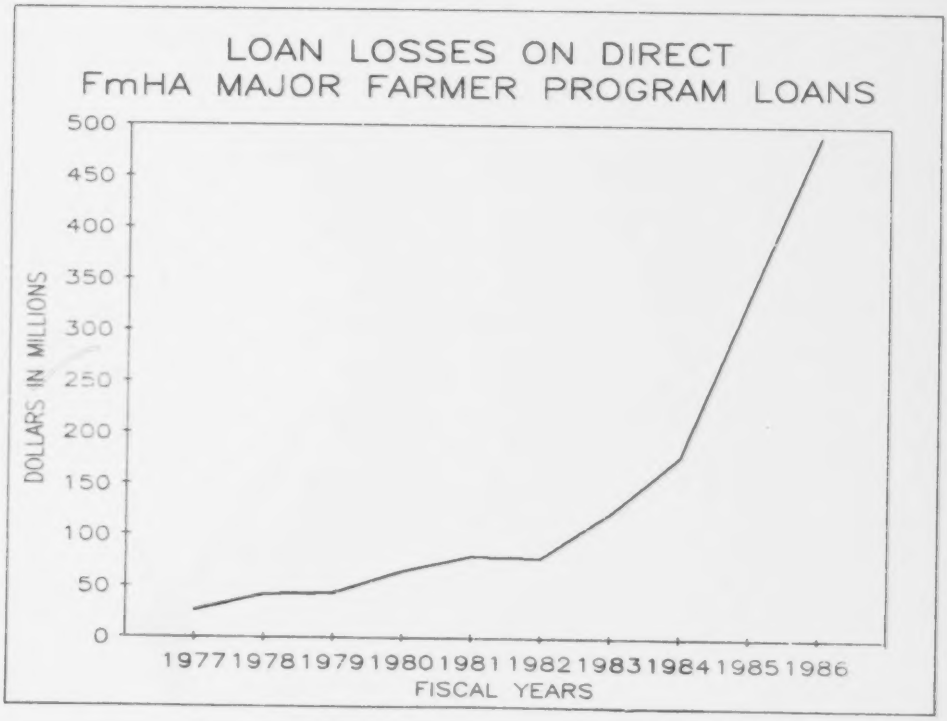

OUTSTANDING PRINCIPAL ON
FmHA MAJOR FARMER PROGRAM LOANS
DOLLARS IN BILLIONS
30
25
20
15
10
5
0
1977 1978 1979 1980 1981 1982 1983 1984 1985 1986
YEAR ENDING JUNE 30


OUTSTANDING PRINCIPAL ON DELINQUENT
FmHA MAJOR FARMER PROGRAM LOANS
DOLLARS IN BILLIONS
20
18
16
14
12
10
8
6
4
2
0
1977 1978 1979 1980 1981 1982 1983 1984 1985 1986
YEAR ENDING JUNE 30


DELINQUENT PAYMENTS ON FmHA
MAJOR FARMER PROGRAM LOANS
DOLLARS IN MILLIONS
7000
6000
5000
4000
3000
2000
1000
0
1977 1978 1979 1980 1981 1982 1983 1984 1985 1986
YEAR ENDING JUNE 30


PAYMENTS DELINQUENT OVER 3 YEARS
ON FmHA MAJOR FARMER PROGRAM LOANS
DOLLARS IN MILLIONS
6000
5000
4000
3000
2000
1000
0
1977 1978 1979 1980 1981 1982 1983 1984 1985 1986
YEAR ENDING JUNE 30


FmHA PORTFOLIO STATUS
MAJOR FARMER PROGRAM LOANS
LEGEND
PRINCIPAL
DEL. PRIN.
DEL. PMTS.
DEL. > 3 YRS.
DOLLARS IN BILLIONS
30
25
20
15
10
5
0
1977 1979 1981 1983 1985
1978 1980 1982 1984 1986
YEAR ENDING JUNE 30


LOAN LOSSES ON DIRECT
FmHA MAJOR FARMER PROGRAM LOANS
DOLLARS IN MILLIONS
500
450
400
350
300
250
200
150
100
50
0
1977 1978 1979 1980 1981 1982 1983 1984 1985 1986
FISCAL YEARS

COMMENTS TO SENATE AGRICULTURE COMMITTEE

BY ROGER A. TELLINGHUISEN, SOUTH DAKOTA ATTORNEY GENERAL

I appear here today out of deep concern for South Dakota's biggest industry: Agriculture. We in South Dakota depend heavily on agriculture for food and for our state economy. And our farmers depend heavily on the Farmers Home Administration to lend them money to produce grain and livestock. Because of our dependence upon agriculture and the FmHA, I view very dimly any attempt to cripple our farmers through lending policies proposed by the FmHA.

These proposed changes in FmHA's lending policies would remove FmHA as the farmer's lender of last resort. That last resort will shift to bankruptcy court.

I have the numbers to prove it.

FmHA is the biggest non-private lender in South Dakota. FmHA made $114 million in all types of loans in South Dakota in Fiscal Year 1987. Approximately $59.8 million was loaned directly to 2,147 farmers by the agency and $47.7 million was obligated to farmers under an FmHA program providing government guarantees on loans issued by commercial lenders. Almost 25 cents of every dollar lent to South Dakota farmers is from the FmHA. The federal agency currently holds 12,000 loans for state farms, and 10,000 housing loans. The agency also owns 190 farms, totaling 155,000 acres in this state, through foreclosures or voluntary liquidations. It is my understanding that FmHA is more involved proportionately in

South Dakota agriculture than almost any other state in the union.

Under the present guidelines, the average farmer in South Dakota can get a loan from FmHA. This is critical because FmHA so vital to this state. Under the new debt/asset ratio and creditworthiness guidelines included in the proposed regulations, the average farmer will not be able to get a loan. In fact, if these proposed regulations are adopted, more than half of the FmHA's current borrowers would be ineligible nationally. I believe this would be substantially true for South Dakota farmers as well. Thirty percent of South Dakota farmers have debt/asset ratios greater than 70 percent, indicating severe credit problems in the next two years. More than 22 percent of our farmers fall within the 41 to 70 percent range.

Farmers are showing up in bankruptcy court with agonizing frequency. The number of farm bankruptcies has tripled since 1983 in our state. Farm bankruptcies in South Dakota in 1985 numbered 338. In 1986 farm bankruptcies rose to 564 and in the first two months of 1987, 153 farmers declared bankruptcy. In 1985, 65 percent of those farmers declaring Chapter 11 bankruptcy listed FmHA as their lender. These farmers had borrowed an average of $249,000. At least 474 FmHA borrowers are now in bankruptcy.

If the lender of last resort is cut off for those remaining marginal farmers, the number of farm bankrupcies can be expected to rise dramatically.

Even those borrowers not facing immediate bankruptcy are concerned. The number of farm debtors contacting the South Dakota Department of Agriculture for some assistance with ag finance counseling has doubled since January 1986. Since the program began in 1984, 1,530 farm debtors have asked for help from the state Ag Department. From January 1986 to the present, there have been 741 new clients.

The South Dakota Farmers Union also has a toll-free hotline. From May 1986 to January 1987, more than 1500 farmers have called for help. Some of the questions farmers asked dealt with FmHA and the Federal Land Bank. Distressed farmers also requested information about Chapter 12 bankruptcy, attorney referrals and farm support groups.

I do not mean to paint an entirely gloomy picture of the farm scene in South Dakota because the overall agricultural debt picture shows some improvement from 1985 to 1986.

Statewide analysis for all agricultural lenders showed that while 20.3 percent of South Dakota farmers increased their total debt, 39.1 percent held the total debt constant, an encouraging 40.6 percent actually decreased their debt. Part of this is certainly due to the fact that many marginal farmers have gone through bankruptcy.

Nonetheless, the overall situation shows some signs of improvement. This remains a very sensitive situation, however, and in my view implementation of the proposed regulations would kill all hope of continued improvement.

This is no time to cut off loans to South Dakota farmers through novel and outrageous interpretations of Congressional directives.

Thank you very much.

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